

United States Government

Department of Energy

memorandum

DATE: January 2, 2008

REPLY TO
ATTN OF: IG-34 (A07FN007)

SUBJECT: Management Letter on the Audit of the Department of Energy's Consolidated Financial Statements for Fiscal Year 2007

TO: Chief Financial Officer, CF-1

Attached is the subject letter prepared by KPMG LLP, our contract auditors. The letter contains 49 new findings (see letter, Exhibit A) and 2 repeat findings (see letter, Exhibit B) that were issued during the course of the Fiscal Year 2007 audit of the Department of Energy's (Department) Consolidated Financial Statements as well as 2 tabled findings (see letter, Exhibit B). Management generally concurred with and provided planned corrective actions for most of the recommendations listed in the Management Letter. For those findings where management did not concur with the finding and/or recommendation, management's comments and the auditor's rebuttal were included in their entirety.

No Departmental position is required for the findings in this report. However, the recommendations are open and should be tracked in the Department's Audit Report Tracking System.

We appreciate the cooperation of your staff during the review.



Rickey R. Hass
Assistant Inspector General
for Environment, Science, and Corporate Audits
Office of Inspector General

Attachment

Audit Report No.: DOE/OAS-FS-08-03

cc w/attachment:

Deputy CFO, CF-2

Team Leader, Audit Liaison, CF-1.2

Director, Office of Finance and Accounting, CF-10

Director, Energy Finance and Accounting Service Center, CF-11

Director, Office of Finance and Oversight, CF-12

Director, Office of Program Analysis and Evaluation, CF-20

Director, Office of Financial Policy, CF-50

Director, Office of Procurement and Assistance Management, MA-60

Chief Operating Officer, EM-3

Deputy Assistant Secretary for Program Planning and Budget, EM-30

Audit Liaison, Environmental Management, EM-33

Manager, Policy and Internal Controls Management, NA-66

Audit Liaison, National Nuclear Security Administration, NA-66

Director, Office of Civilian Radioactive Waste Management, RW-1

Audit Liaison, Office of Civilian Radioactive Waste Management, RW-2

Audit Liaison, Fossil Energy, FE-3

Assistant Secretary, Nuclear Energy, NE-1

Audit Liaison, Nuclear Energy, NE-42

Chief Operating Officer, Office of Science, SC-3

Audit Liaison, Office of Science, SC-32.1

Chief Health, Safety and Security Officer, HS-1

Audit Liaison, Office of Health, Safety and Security, HS-1.23

Site Manager, Berkeley Site Office

Audit Liaison, Berkeley Site Office

Director, Office of Legacy Management, LM-1

Audit Liaison, Office of Legacy Management, LM-5

Manager, Chicago Office

Audit Liaison, Chicago Office

Manager, Idaho Operations Office

Audit Liaison, Idaho Operations Office

Manager, Los Alamos Site Office

Manager, Livermore Site Office

Director, Sandia Site Office

Manager, Kansas City Site Office

Manager, Y-12 Site Office

Manager, Nevada Site Office

Manager, Portsmouth Paducah Project Office

Audit Liaison, Portsmouth Paducah Project Office

Manager, Oak Ridge Office

Audit Liaison, Oak Ridge Office

Manager, Pittsburgh Naval Reactors Office

Manager, Richland Operations Office

Audit Liaison, Richland Operations Office

Manager, Office of River Protection

Audit Liaison, Office of River Protection

Manager, Savannah River Operations Office

Audit Liaison, Savannah River Operations Office

Director, National Energy Technology Laboratory
Audit Liaison, National Energy Technology Laboratory
Audit Liaison, Lawrence Livermore National Laboratory



KPMG LLP
2001 M Street, NW
Washington, DC 20036

MANAGEMENT LETTER

December 10, 2007

Mr. Gregory Friedman
Inspector General
U. S. Department of Energy
1000 Independence Avenue, S.W. Room 5D-039
Washington, D.C. 20585

Dear Mr. Friedman:

We have audited the consolidated financial statements of the United States Department of Energy (Department or DOE) as of and for the year ended September 30, 2007, and have issued our report thereon dated November 9, 2007. The full text of our *Independent Auditors' Report* is included in the financial section of the Department's *Fiscal Year 2007 Agency Financial Report*.

In planning and performing our audit of the consolidated financial statements, in accordance with auditing standards generally accepted in the United States of America, we considered the Department's internal control over financial reporting (internal control) in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control.

Our consideration of internal control was for the limited purpose described in the proceeding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weakness. However, as discussed below, we identified certain deficiencies in internal control that we collectively consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's consolidated financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control.



We identified deficiencies in the Department's internal controls over identifying and recording environmental liabilities accurately, completely, and timely, and that collectivity we consider to be a significant deficiency. Specific findings that contribute to this significant deficiency are presented in Exhibit A, in Findings 1 through 3. We do not consider this significant deficiency to be a material weakness.

Although not considered significant deficiencies or material weaknesses, we noted certain matters involving internal controls and other operational matters that are presented in Exhibit A, Findings 4 through 49, for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the Department's internal controls or result in other operating efficiencies.

Exhibit B presents the status of prior year management letter comments and includes two findings related to performance measurement reporting that we issued in Fiscal Year (FY) 2006 and for which we have not evaluated corrective actions because the Department participated in a FY 2007 pilot program for producing an *Agency Financial Report* (AFR), rather than a *Performance and Accountability Report*, in FY 2007 which does not include detailed performance measures. As such, testing internal controls over performance measures was not part of our FY 2007 audit scope. The Office of Inspector General plans to test performance measures in conjunction with the Department's issuance of an *Annual Performance Report* in February 2008, and will follow up on these findings at that time.

We also issued a separate management letter dated December 3, 2007, addressing information technology control deficiencies, some of which we consider collectively to be a significant deficiency.

The maintenance of adequate internal control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the Department.

We appreciate the courteous and professional assistance that Department personnel extended to us during our audit. We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the U. S. Department of Energy and its Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Management Letter
Index to Exhibit A and Listing of Other Exhibits

**Comments Related to Internal Controls and Other Operational Matters (with
parenthetical references to findings and recommendations issued during the engagement)**

	Exhibit A
Environmental Liabilities	
Finding 1: Update of High Level Waste and Spent Nuclear Fuel Disposition Liability Estimate (07-XN9-OEL-01)	A.1
Finding 2: Waste Isolate Pilot Plant Environmental Liability Balance (07-XN9-EL-01)	A.2
Finding 3: Misstatement of the Interim Fiscal Year 2007 Environmental Liabilities Balance (07-RL9-EL-01)	A.4
Finding 4: Environmental Liability Cost Estimates (07-WAK/L-EL-01)	A.5
Finding 5: Headquarters Program Direction and Policy Management Estimates (07-XN9-EL-02)	A.7
Finding 6: Duplicate Facilities in Environmental Liabilities (07-NS1-EL-01)	A.8
Finding 7: Error in Beginning Balance - Calcine Disposition Liability (07-ID9-EL-01) (Revised)	A.9
Finding 8: Future Waste Costs in Restructured Environmental Liability (07-ID9-REL-01)	A.11
Finding 9: Los Alamos Restructured Environmental Liability (07-NS1-REL-01)	A.11
Environmental Liabilities for Active Facilities	
Finding 10: Inaccuracies in the Active Facilities Data Collection System (07-XN9-AF-01)	A.13
Finding 11: Inaccuracies in the Active Facilities Data Collection System (07-XN9-AF-02)	A.14
Finding 12: Inaccuracies in the Active Facilities Data Collection System (07-NST-AF-01)	A.15
Finding 13: Inaccuracies in the Active Facilities Data Collection System (07-NS3-AF-01)	A.18
Environmental Safety & Health (ES&H) Liabilities	
Finding 14: Audit Evidence Required for ES&H Compliance Liability Estimate (07-FT9-ESH-01)	A.19
Inventory	
Finding 15: Inventory Observation (07-NST-OI-01)	A.21
Finding 16: Boron Valuation (07-NST-OI-02)	A.22
Finding 17: September Activity in Nuclear Materials Inventory (07-NS1-NM-01)	A.25
Finding 18: Obsolete Inventory (07-NS1-NM-02)	A.26
Property, Plant, and Equipment	
Finding 19: Gain/Loss Recognition on Disposal of Fixed Assets (07-CH2-PPE-01)	A.27
Finding 20: Gain/Loss Recognition on Disposal of Fixed Assets (07-CHF-PPE-01)	A.28
Finding 21: Timeliness of Capitalization (07-CHF-PPE-02)	A.29
Finding 22: Unidentifiable Assets Capitalized (07-CHF-PPE-03)	A.30
Finding 23: Inaccurate Property Costs (07-NS3-PPE-01)	A.31

Management Letter
Index to Exhibit A and Listing of Other Exhibits - Continued

Finding 24: Construction-In-Process (07-NS9-PPE-02)	A.32
Finding 25: Inaccurate Property Costs (07-NS9-PPE-01)	A.34
Finding 26: Retroactive Depreciation Expense (07-XN9-PPE-01)	A.34
Finding 27: Inaccurate Account Balance (07-XN9-PPE-02)	A.35
Payroll	
Finding 28: Updated Life Insurance Withholding (07-NS9-HR-01)	A.36
Finding 29: Updated Health Benefit Withholding (07-XN9-HR-01)	A.37
Finding 30: Time Card Approval (07-NSH-HR-01)	A.38
Finding 31: Payroll Withholding Authorization (07-NSH-HR-02)	A.39
Finding 32: Military Leave of Absence (07-NSH-HR-03)	A.40
Accruals	
Finding 33: Project Accruals (07-NST-PRO-02)	A.42
Finding 34: Financial Assistance Award True-up Process (07-FT9-GL-01)	A.42
Finding 35: Inconsistent Application of Grant Costing Policy (07-XN9-GL-01)	A.43
Finding 36: Accrued Expenses (07-NS9-PRO-01)	A.44
Accounts Payable	
Finding 37: Incorrect Journal Entries (07-SR9-PRO-01)	A.45
Finding 38: Incorrect Journal Entries (07-CH9-PRO-01)	A.46
Finding 39: Invalid Accounts Payable Balances (07-XN9-PRO-01)	A.47
Finding 40: Recording Lease Liabilities (07-OR9-PRO-01)	A.48
Finding 41: Separation of Duties (07-NST-PRO-01)	A.49
Intragovernmental Transactions	
Finding 42: Incorrect Trading Partner Code (07-XN9-INTG-01) (Revised)	A.50
Undelivered Orders	
Finding 43: Costing of Grant Awards (07-CH9-GL-01)	A.50
Finding 44: Misstatement of June 30, 2007 Cumulative Obligations (07-RL9-BUD-01)	A.52
Finding 45: Backlog of Inter-entity Cost Transfers (07-XN9-BUD-01)	A.53
Work-for-Others	
Finding 46: Work-for-Others (07-NSH-REV-01)	A.55
Finding 47: Work-for-Others (07-NSH-REV-02)	A.56
Managerial Cost Allocation	
Finding 48: Incomplete Written Procedures (07-XN9-FR-01)	A.57
Required Supplementary Stewardship Information	
Finding 49: Improved Controls over Required Supplementary Stewardship Information Reporting (07-XN9-FR-02)	A.58
Status of Prior Year Findings	Exhibit B
Acronyms	Exhibit C

COMMENTS

Environmental Liabilities

Background: The Department has several categories of environmental liabilities, including the Environmental Management (EM) Program's baseline estimates for its cleanup projects; stabilization, deactivation, and decommissioning of active facilities; and Restructured Environmental Liabilities (REL), covering cleanup projects and facilities that are not addressed in the EM or active facilities liabilities.

Finding 1: Update of High Level Waste and Spent Nuclear Fuel Disposition Liability Estimate (07-XN9-OEL-01)

The Office of Civilian Radioactive Waste Management (OCRWM) did not use EM's current estimate of defense waste requiring disposal at the high-level waste repository in estimating the Department's estimated \$16.4 billion share of future costs at September 30, 2007. In addition, OCRWM used an estimated repository opening date that was not the most likely date in view of anticipated project delays.

OCRWM uses sharing formulas to calculate a liability for each generator of waste. The Department bases its liability on estimates of defense waste from the Department's Naval Reactors organization and EM. The estimated number of defense waste packages is a key element in OCRWM's determination of the defense share liability. OCRWM did not use EM's current estimate of defense waste requiring disposal at the repository because there was a lack of coordinated effort to resolve discrepancies between the programmatic assumptions of the two organizations. The Department recorded an audit adjustment of \$4.4 billion to correct the defense waste disposal liability based on current defense waste volume estimates.

OCRWM based its defense share estimate on a 2017 opening date assumption because that date is included in the repository timetable announced by the program in 2006. The Department recorded a second audit adjustment of \$154 million to correct the misstatement that resulted from using an outdated opening date assumption.

Recommendation:

1. We recommended that OCRWM and EM develop procedures for adequate coordination between these offices in the development of cost estimates to ensure that annual updates to the estimates are based upon current information and consistent assumptions.

Management Reaction:

The Department concurs with the recommendation to develop procedures to ensure adequate coordination occurs between EM and OCRWM in the development of cost estimates to ensure that annual updates to the estimates are based upon current information and consistent assumptions.

COMMENTS

To address the recommendation, procedures will be developed to ensure EM provides updated spent nuclear fuel and high level waste canister estimates to OCRWM, and OCRWM provides an updated repository operations schedule to EM on a periodic basis so that annual reporting of the environmental liability is based on current information and consistent assumptions.

Further, lessons learned from the audit are being compiled and will be incorporated into a standard operating procedure for recording environmental liabilities. This procedure will address the timely incorporation of revised estimates and adjustments, and the review of assumptions regarding inter-site dependencies such as waste shipments between sites or to the high-level waste repository. The Department will have the new procedure in place to support the issuance of the spring budget formulation guidance and development of the FY 2008 environmental liability estimate.

**Finding 2: Waste Isolation Pilot Plant Environmental Liability
(07-XN9-EL-01)**

The EM liability as of September 30, 2006, did not include an estimate of the additional costs to be incurred by the Waste Isolation Pilot Plant (WIPP) as a result of a revised shipping schedule for transuranic (TRU) waste from the Office of River Protection (ORP). In FY 2006, ORP extended its baseline estimates to include shipments of TRU waste to WIPP through FY 2033. However, WIPP's baseline estimates anticipated the receipt of TRU waste only through FY 2030.

In addition, WIPP's revised FY 2007 estimate included an overly conservative assumption with respect to the level of operations from FY 2030 to FY 2045. The revised estimate assumed operating costs would continue at approximately 90 percent of the average peak period operating costs instead of ramping down to approximately 50 percent as in past estimates. WIPP's estimate was based on updated operating experience receiving remote-handled TRU waste and an increased level of waste generator site support through the Central Characterization Project aimed at improving the efficiency of WIPP by maximizing shipping receipts. WIPP based the estimate on being ready to receive waste rather than on actual shipping schedules. Discussion with EM personnel indicated that a much lower level of receipts is likely since at this time, only one generator site, ORP, had identified a waste stream that includes shipments after FY 2030. Another site, Richland, noted that it would potentially be generating TRU waste in the post-2030 time frame but did not have specific information about shipping rates or schedules.

WIPP did not receive an update of ORP's schedule for TRU waste shipments prior to recording its final baseline estimates for FY 2006. The TRU waste shipment schedule for ORP and other sites changed in FY 2006 due to changes in project schedules and sequencing, but many of these changes were not provided to WIPP during FY 2006. WIPP was aware that changes had occurred and because it did not receive revised

COMMENTS

shipment schedules, it revised its estimate to assume a level of readiness not consistent with the waste shipments currently identified.

EM's review of site baseline estimates did not detect the variance between ORP's schedule for TRU waste shipments and WIPP's schedule for TRU waste receipts because its fiscal year-end review procedures generally do not seek to identify such discrepancies. Instead, EM relies upon its field sites to revise their baseline estimates annually based upon the latest available information, and to communicate changes in cost and schedule estimates to other sites impacted by the changes.

Because WIPP did not receive ORP's revised schedule in FY 2006, its environmental liabilities were understated by about \$270 million at September 30, 2006.

WIPP's use of overly conservative assumptions on its FY 2007 estimate resulted in an overstatement of its environmental liabilities, prior to correction, of about \$1.1 billion at September 30, 2007.

Recommendation:

2. We recommended that the Department's Chief Financial Officer (CFO) work with EM to develop procedures for an annual review of assumptions regarding inter-site dependencies in the EM baseline estimates to ensure consistency.

Management Reaction:

The Department concurs with the recommendation to develop procedures for an annual review of assumptions regarding inter-site dependencies in the EM baseline estimates to ensure consistency.

To address the recommendation, procedures will be developed to ensure EM sites provide updated contact and remote handled TRU quantity estimates to the Carlsbad Field Office so that annual reporting of the environmental liability is based on current information and consistent assumptions.

Further, lessons learned from the audit are being compiled and will be incorporated into a standard operating procedure for recording environmental liabilities. This procedure will address the timely incorporation of revised estimates and adjustments, and the review of assumptions regarding inter-site dependencies such as waste shipments between sites or to WIPP. The Department will have the new procedure in place to support the issuance of the spring budget formulation guidance and development of the FY 2008 environmental liability estimate.

COMMENTS

Finding 3: Misstatement of the Interim Fiscal Year 2007 Environmental Liabilities
Estimated Balance (07-RL9-EL-01)

Richland Operations Office (Richland) did not revise its estimate of interim cleanup program costs from FY 2036 to FY 2048 to reflect the increased estimate for site services and groundwater remediation through FY 2035. These omissions resulted in adjustments of \$379 million and \$364 million, respectively, to the site services and groundwater remediation estimates. In addition, Richland did not include a provision for execution risk in its management reserve for the solid waste project, resulting in an understatement of the liability of \$428 million.

The environmental liabilities estimates through the third quarter did not include these adjustments; however, Richland recorded adjustments for the understated environmental liabilities by September 30, 2007.

The errors and omissions occurred because Richland has not established a process for review and approval of estimates prepared by the Richland staff to identify errors and omissions and to compare the assumptions in the estimates to corresponding assumptions in other components of the liabilities.

Through the third quarter of FY 2007, Richland understated its environmental liabilities by a total of \$1.171 billion, prior to audit adjustment. However, at fiscal year-end the environmental liabilities were recorded accurately.

Recommendation:

3. We recommended that the Manager, Richland, establish a process to provide effective management reviews of new and revised cost and schedule estimates prepared by the Richland Operations Office to identify errors and omissions and to compare those estimates to corresponding assumptions in other components of the liabilities.

Management Reaction:

Richland Operations Office performed a cursory review for the estimates described in the condition section as interim program costs. However, due to other priorities (new contract activities and preparations for an external independent review), Richland's limited baseline development resources were directed toward preparing revised, more detailed estimates versus additional reviews of interim costs or "placeholder" estimates recognizing these would be replaced when completed; and reviewed and certified through EM's internal control guidance for developing and maintaining baseline estimates.

Richland acknowledges the need to establish a process to provide effective management reviews of new and revised cost and schedule estimates prepared by Richland to identify errors and omissions and to compare those estimates to corresponding assumptions in other components of the liabilities.

COMMENTS

Corrective actions are:

- The addition of resources through the EM Best-in-Class initiative for Project Management to relieve the traditional resource constraint for baseline development and review by August 2008.
- Review and update, as appropriate, the baseline development procedure in the Richland Integrated Management System by September 30, 2008 to incorporate steps for review of the baseline for identification of errors or omissions and compare to the other components of the liability.

Finding 4: Environmental Liability Cost Estimates (07-WAK/L-EL-01)

We previously reported that the supporting documents provided by the Portsmouth Paducah Project Office (PPPO) did not agree with the amounts included in the summary baseline estimates for: (1) Paducah Long-Term Stewardship – subprojects (a) Safeguards & Security, and (b) Environmental Monitoring; and (2) Portsmouth Long-Term Stewardship – subprojects (a) Post-Remediation Surveillance and Maintenance, and (b) Environmental Monitoring. We recommended the establishment of procedures and controls to ensure that recorded environmental liabilities are accurate, complete, and supported by appropriate documentation. Management responded that a final integrated baseline for each site was expected in the third quarter of FY 2007, at which time it would address the development of updated long-term stewardship estimates that incorporate updated project completion assumptions.

PPPO officials advised that, as of September 30, 2007, there had been no change in the underlying support for the Paducah or Portsmouth Long-Term Stewardship project estimate and they have not developed an updated detailed estimate of Long-Term Stewardship costs for either site.

In addition, during our review of the depleted uranium conversion liability estimate, we noted that approximately \$62 million of estimated costs associated with additional material to be converted were not included in the liability as recorded at September 30, 2007.

PPPO officials neither provided the current status of plans to update long-term stewardship estimates, nor explained why previously-provided data did not agree with amounts included in the summary baseline estimates for FY 2006. PPPO officials reiterated that they continued to have difficulty obtaining detailed supporting documentation for these estimates, which were prepared years ago. PPPO officials emphasized that updating the Portsmouth and Paducah Long-Term Stewardship project estimates remain a priority.

PPPO officials stated that the omission of the additional material from the depleted uranium conversion estimate was a result of human error. The cost associated with the additional material was overlooked when the current year liability was updated. DOE

COMMENTS

headquarters recorded a post closing entry to properly reflect the liability in the financial statements as of September 30, 2007.

PPPO's Long-Term Stewardship Liability of \$1.3 billion as of September 30, 2007 could not be verified and may be under or over-reported, resulting in an inaccurate environmental liability amount in the Department's financial statements.

PPPO depleted uranium conversion liability was understated by approximately \$62 million as of September 30, 2007, before the post-closing entry recorded to adjust the liability.

Recommendation:

4. We recommended that EM, in conjunction with the Department's CFO, require the EM Consolidated Business Center and PPPO to establish procedures and controls which ensure that recorded environmental liabilities are accurate, complete, and supported by appropriate documentation.

Management Reaction:

The Environmental Management Consolidated Business Center (EMCBC) concurs with the finding and recommendation with regard to Long-Term Stewardship (LTS). As a result of the focus on other integral activities, which ultimately should precede a change in the estimate for LTS at the Portsmouth (PORTS) and Paducah (PAD) sites, PPPO planned on updating the LTS estimate after these activities were complete. Some of these other activities included (1) the development of an acquisition package for procurement of a Decontamination and Decommissioning contractor at PORTS; (2) the validation of PORTS and PAD near-term baselines; and (3) the development of the 2007 Report to Congress on the Uranium Enrichment Decontamination and Decommissioning Fund. The Report to Congress considers a number of revised and updated assumptions concerning the future of the Portsmouth and Paducah sites that ultimately impact the LTS costs at these sites. The current LTS planning supported the development of the LTS GEN-2. This estimate was reviewed against the current LTS costs at the Fernald site and appears comparable. As such, the current estimate was considered reasonable under the circumstances prevalent during FY 2007.

Nonetheless, based upon the concerns expressed in this finding regarding the necessary detail to support LTS estimates, the EMCBC and PPPO have commissioned the development of an updated LTS cost estimate by December 14, 2007, using parametric estimating techniques. This estimate will be developed by PPPO and independently reviewed by the EMCBC Cost Estimating/Analysis Center. Subsequent to the approval of this estimate, PPPO will submit a Preliminary Request Notice (PRN) to update the PPPO LTS Project Baseline Summary (PBS). The PRN will be utilized as the basis to update the FY 2008 First Quarter PPPO Environmental Liability estimate in January 2008.

COMMENTS

The EMCBC concurs with the finding and recommendation with regard to depleted uranium. Neither of these findings have a material impact on the FY 2007 financial audit.

**Finding 5: Headquarters Program Direction and Policy Management Estimates
(07-XN9-EL-02)**

EM extended its estimates at Hanford during FY 2006 to include work scope for the period from FY 2036 through FY 2048. The EM liability as of September 30, 2006, did not include an estimate of the additional costs for program direction and policy management for the same extended period. EM should have extended the timeline for its program direction and policy management projects to coincide with the timeline for EM operations at Hanford.

In addition, EM overstated the liability for policy management costs as of September 30, 2006, because it did not consider a decrease in policy management costs consistent with the overall decrease in EM's operations through FY 2035.

EM's year-end review of site baseline estimates did not include policies and procedures designed to detect the differences between schedules for site baseline estimates and headquarters support programs.

EM understated environmental liabilities for program direction by about \$303 million and overstated environmental liabilities for policy management by about \$290 million at September 30, 2006, for a net understatement of \$13 million. At the auditor's request, the Department made the corrections to the financial statements as of September 30, 2007.

Recommendation:

5. We recommended that EM develop procedures for an annual review of assumptions in the EM baseline estimates to ensure consistency.

Management Reaction:

The Department concurs with the recommendation to develop procedures for an annual review of assumptions regarding inter-site dependencies in the EM baseline estimates to ensure consistency. To address the recommendation, a procedure and process will be developed to ensure that the program direction and support costs for policy management reflect revised cost estimates and adjustments that occur late in the financial reporting period.

During the audit last year, adjustments for the extension of the Waste Treatment Plant project and the resultant extension of the tank farm operations and impacts to remediation of the Central Plateau were recorded outside of Integrated Planning, Accountability, and

COMMENTS

Budgeting System (IPABS) and late in the financial reporting period, after the program direction and policy management costs had been updated. EM will revise its process so that any large adjustments to the environmental liability will include a provision for program direction and policy management costs.

environmental liability estimate. It is being compiled and will be incorporated into a

Finding 6: Duplicate Facilities in Environmental Liabilities (07-NS1-EL-01)

At Los Alamos National Laboratory (LANL), a comparison of facilities and structures in the EM records to those in the Active Facilities Data Collection System (AFDCS) indicated that certain facilities in Technical Area (TA)-21 and TA-54 were included in both populations. The duplication resulted in Los Alamos recording a provision for deactivation and decommissioning (D&D) of these facilities in both the EM and active facilities liabilities. After discussion, EM officials agreed that these facilities should be included in the active facilities liability rather than in the EM liability, because EM is not the site "landlord."

LANL EM personnel were not aware that D&D costs for the TA-21 and TA-54 facilities were accounted for in the environmental liability for active facilities. Furthermore, the facility D&D costs included in the LANL EM project baseline estimate had not been reviewed by EM Headquarters.

The duplication errors resulted in an overstatement of the EM liability by \$132 million as of September 30, 2006, and \$129 million, prior to correction, as of September 30, 2007.

Recommendation:

6. We recommended that the National Nuclear Security Administration's (NNSA) Field CFO, in conjunction with the Revitalization Manager, Los Alamos Site Office, direct LANL's CFO to work with its Facilities Management office to develop a corrective action plan to prevent future double counting of facility D&D liabilities. No adjustment is required, however, because Los Alamos corrected the errors prior to the final calculation of the EM liability.

Management Reaction:

The EM PBS VL-LANL-0040D includes the decontamination and demolition of facilities at TA-54 and TA-21 in the lifecycle baseline (future estimated costs). The AFDCS also includes these facilities. The EM timeline of the D&D of these buildings is consistent

COMMENTS

with the LANL AFDCS. In order to ensure that there is not duplication in recording the D&D of these buildings in LANL's future environmental liability on year end financial statements, LANL EM Program will conduct an annual reconciliation with the LANL custodians of the AFDCS. The reconciliation will address the specific building and coordinate the appropriate transfer of these facilities from the AFDCS calculation of the sites future environmental liability to the EM Program's life cycle baseline future estimated costs calculation.

**Finding 7: Error in Beginning Balance - Calcine Disposition Liability
(07-ID9-EL-01) (Revised)**

Idaho Operations Office (Idaho) did not fully update its environmental liabilities for the updated cost estimate included in an independent evaluation (*Independent Calcine Disposition Project Review and Cost Estimate*, prepared by C/P/E Environmental Services, LLC) of the calcine disposition and treatment alternatives in May 2006.

The independent evaluation reported the estimated cost of calcine disposition in constant dollars. We believe that Idaho incorrectly compared the cost estimate in the independent evaluation to the future dollar cost estimate and determined that the amounts were not significantly different, and as a result, did not record an adjustment to the recorded amount. The constant dollar estimate recorded by Idaho as of September 30, 2007 was about \$350 million less than the estimated liability based on the independent evaluation.

Idaho understated its environmental liabilities by about \$350 million at September 30, 2006.

Recommendation:

7. We recommended that the CFO, Idaho, implement policies and procedures that ensure that environmental liabilities are properly updated to agree with the most current cost estimates using constant dollars.

Management Reaction:

Management concurs in principle with the recommendation but the issues disclosed in this finding already exist within the Idaho Operations Office internal control structure given that Idaho currently has procedures in place to ensure that environmental liabilities are properly updated using the most current cost estimates available, using constant dollars. Idaho's policy is to review and analyze each estimate and test for reasonableness prior to changing any number under configuration control. Some estimates are much more detailed and complex depending upon the work scope identified, technology involved, political environment, regulatory situation, assumptions, risk, etc. Reasonableness testing for these items takes more time than for simple and straightforward cost estimates. It is inappropriate at year-end to make an adjustment for every cost estimate received during the year, as some cost estimates may simply not be reasonable and/or verifiable at that time. Therefore, Idaho did not record an adjustment

COMMENTS

in FY 2006 for the above-mentioned independent cost estimate since Idaho had not yet completed its reasonableness/validation review.

Idaho maintains it did not understate its environmental liability, nor was there an error in the beginning balance as the process to update the life cycle baseline and the environmental liability was followed, which ensures internal control and proper configuration management for both the life cycle baseline and financial statement adjustments. Even if constant and current dollars had not been used in the independent validation, Idaho would not have made an adjusting entry because we feel there was adequate coverage in contingency to support any potential change in estimate. Adjustments to either the life cycle baseline or environmental liability without reasonableness reviews and based solely on availability of cost estimates, as recommended in this finding, would supersede our internal control thresholds, violate our configuration control process, and distort the life cycle baseline and the environmental liability.

Auditor Comment:

EM's guidance affirms that each field office has a responsibility to update its liability estimate at the end of every fiscal year, and must document that it has reviewed its estimates for subsequent events. Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant and Equipment*, requires that estimates be revised if there is evidence that material changes have occurred. Generally accepted accounting principles do not allow an entity to defer the assessment of available information based on time, resource, or other constraints. Instead, the estimates and the related liability must be revised based on the best information available when the financial statements are issued.

To comply with EM's guidance and the accounting standards, EM Headquarters and field sites often update their EM liabilities at year-end based upon "placeholder" estimates. The quality of placeholder estimates is dependent upon the time and information available to prepare them, and they are typically replaced in the succeeding fiscal year by estimates prepared and approved using EM's configuration control procedures. In FY 2006, Idaho asserted that a placeholder adjustment was not necessary, but that assertion was based on a flawed analysis. Idaho had compared the recorded liability to the future dollar cost estimate rather than the constant dollar estimate and incorrectly concluded that the recorded liability as of September 30, 2006, was about equal to the new estimate. In view of this error and Idaho's increase of its liability in FY 2007 based on the new estimate, we concluded that Idaho should have adjusted the recorded liability as of September 30, 2006. We suggest that Idaho ensure that its liability assessments use constant dollars.

COMMENTS

**Finding 8: Future Waste Costs in Restructured Environmental Liability
(07-ID9-REL-01)**

Idaho's REL estimate included costs related to generating future nuclear waste. Future waste is not a past transaction or event for Federal accounting purposes. Idaho's REL estimate of \$398 million in FY 2007 included \$340 million for future waste to be generated by the Office of Nuclear Energy. Specifically, the estimate related to Idaho's costs for contact handled, and remote handled, low level waste that Idaho will not generate until Fiscal Year 2008 and beyond. The generation of wastes subsequent to the balance sheet date is not a past transaction or event for Federal accounting purposes, and the associated waste management costs should not be recorded as a liability.

Idaho had not established controls to ensure that it would not include costs associated with a future event in its REL estimate.

Idaho overstated its REL estimate by \$340 million in the Department's financial statements as of September 30, 2007.

Recommendations:

8. We recommended that Idaho's CFO take action to:
 - a. Remove the \$340 million in costs associated with future waste from the REL estimate, and
 - b. Develop procedures to ensure that future REL estimates do not include costs associated with waste Idaho expects to generate in the future.

Management Reaction:

Idaho concurs with the recommendation and will make the appropriate adjustments. However, Idaho believes our internal controls are already sufficient to properly account for environmental liabilities. However, we feel there is a lack of clarity in current Department policy as to the appropriate classification of an environmental liability. This is causing confusion and differences of interpretation among Departmental entities and the auditors. Therefore, Idaho suggests additional Departmental policy be issued to clarify the classification definitions.

Finding 9: Los Alamos Restructured Environmental Liability (07-NS1-REL-01)

In FY 2006, LANL recorded an amount of \$172 million for its REL estimate which represented an escalated value from the original \$160 million identified as a placeholder value under the Future Liabilities Report for excess materials. Based on supporting documentation examined in FY 2007, the excess materials liability in FY 2006 should have been \$14.4 million.

In addition, LANL did not record a liability of \$172 million in FY 2006 for the remediation of solid waste management units (SWMU), consisting of firing sites and drain lines.

The amounts identified above were not communicated to LANL's CFO for inclusion in LANL's financial records which are integrated with the Department's financial records.

In addition, LANL's CFO had not established procedures to obtain updated REL estimates and to verify the timely inclusion of the resulting liabilities in its accounting records.

The net impact of these errors was an understatement of the REL balance by \$14.4 million as of September 30, 2006.

Recommendation:

9. We recommended that NNSA's Field CFO, in conjunction with the Revitalization Manager, Los Alamos Site Office, direct LANL's CFO to establish procedures for obtaining and recording REL estimates timely.

Management Reaction:

In years past, the REL estimate (or the non- EM program environmental liability) for LANL was a result of DOE escalating a number of \$160 million that was provided to LANL in 2003 by DOE Headquarters. The number was based on the DOE "James Owendoff Report" to the Undersecretary for Energy, Science and Environment dated 10/31/03 titled "Final Report on Future Waste Management and Remediation Liabilities". The REL estimate reported for FY2006 was \$172 million (\$160 million escalated).

In 2007, DOE Headquarters asked LANL to provide a number that was based on site supported information in conjunction with the KPMG DOE LANL site audit.

The LANL CFO and EM personnel were able to provide information that can be sourced to the "Ten Year Site Plan" for the SMWUs requiring remediation that are not included in the EM baseline (drain lines and firing sites) of \$144 million. Another \$26.5 million of liability can be sourced to the Weapons Program maintained data sheet called Inactive/Excess Materials that indicated costs of future disposal.

Together these supported costs equal \$170.5 million for 2007.

Corrective Action: LANL CFO and EM personnel will validate and source the REL estimated each year in conjunction with providing data for fiscal year end and the management representation letter. The process and sources for FY 2007 have been documented and will be followed in subsequent years.

COMMENTS**Environmental Liabilities for Active Facilities**

Background: The Department's liability for remediation of active facilities includes anticipated remediation costs for active and surplus facilities managed by the Department's ongoing program operations and will ultimately require stabilization, deactivation, and decommissioning. The estimated costs are largely based on a cost-estimating model which extrapolates stabilization, deactivation, and decommissioning costs from facilities included in EM's baseline estimates to those active and surplus facilities with similar characteristics. The cost-estimating model uses facility data from the AFDCS managed by the Office of Finance and Accounting Policy within the Office of the CFO and operated by a contractor. Field site personnel, called Site Data Contacts, are responsible for entering the facility data and ensuring the completeness and accuracy of the data, which includes cost model category and facility size.

To test the reliability and accuracy of the AFDCS data in FY 2007, we performed detailed tests of the data at five locations. We also inquired as to the existence of newly contaminated facilities and verified their inclusion in the AFDCS database. We identified errors at the following three sites, LANL in New Mexico; the Lawrence Livermore National Laboratory (LLNL) in California; and the Kansas City Plant (KCP). In addition, a follow-up review of a prior year finding at Lawrence Berkeley National Laboratory (LBNL) disclosed a deficiency requiring correction at the Headquarters level.

**Finding 10: Inaccuracies in the Active Facilities Data Collection System
(07-XN9-AF-01)**

Our review disclosed a previously-assigned "exclusion code" in the AFDCS database for one newly contaminated facility (TA 54-0049) at LANL. The exclusion code caused the facility to be excluded from the liability estimate. LANL had previously incorrectly classified the facility as a "trailer or land" although TA 54-0049 is a building measuring over 25,000 square feet. A LANL official confirmed that the appropriate facility model type for this facility is "E – Building with Radioactive Contamination."

Department Headquarters initially populates the facility-specific information in the AFDCS annually from data listed in the Department's Facilities Information Management System (FIMS). Field sites are required to review and validate the facility data used to calculate the site's active facilities liability. Although LANL corrected the cost model type in the AFDCS for TA 54-0049 when identifying it as a contaminated facility, it did not remove the exclusion code previously designated based on the facility's FIMS data.

The exclusion of TA 54-0049 resulted in an understatement of \$15,949,461 in LANL's active facilities liability as of June 30, 2007. However, the Department corrected this error before calculating the active facilities liability as of September 30, 2007.

COMMENTS

Recommendation:

10. We recommended that the Office of the CFO continue efforts to ensure the accuracy of AFDCS data. The Office of the CFO should emphasize to the sites the importance of reviewing facility exclusions and the accuracy of any current year changes. Specifically, this may include the implementation of an automated confirmation in AFDCS requiring the sites to validate any excluded contaminated facility.

Management Reaction:

Management concurs with the recommendation. In the annual guidance for FY 2008, the importance of reviewing facility exclusions will be emphasized. Further, an automated control has been added to AFDCS requiring the sites' to confirm whether a facility should remain excluded from the liability calculation when a cost model change is made.

**Finding 11: Inaccuracies in the Active Facilities Data Collection System
(07-XN9-AF-02)**

Follow-up procedures relating to a prior year finding at LBNL disclosed that the site had inappropriately changed the AFDCS model types relating to 14 facilities. During the interim period ended June 30, 2007, LBNL changed the cost model codes for (a) eight facilities from "no liability" to "E" (Buildings with Radioactive Contamination), (b) five facilities from "G" (Building with Hazardous Only) to "F" (Building with mixed waste - both hazardous and radioactive), and (c) one facility from "no liability" to "F". Specific facility information follows:

Building Number	Interim Cost Model Type	Final Cost Model Type	Interim Overstatement
50A	E	No Liability	\$ 37,179,976
50B	E	No Liability	35,781,492
2	F	No Liability	34,166,772
977	E	No Liability	31,096,041
77	F	G	(3,143,145)
66	E	No Liability	25,137,924
62	F	G	(3,073,662)
76	F	G	(1,585,628)
25	F	G	(946,420)
72C	E	No Liability	5,165,262
72	E	No Liability	3,550,001
63	F	G	(84,863)
67/67A	E	No Liability	1,351,226
75C	E	No Liability	638,320
Total:			\$ 165,233,296

The cost model code of one facility listed in a prior year finding (Building 75A) resulted in the site consulting additional guidance, including DOE Order 5400.5, *Radiation*

COMMENTS

Protection of the Public and the Environment. The site subsequently applied this additional guidance to the facilities listed above resulting in overly conservative cost model codes. The site considered certain facilities contaminated regardless of any known or potential contamination within the Facilities' structural components. Based on facility history, there is concern of radioactive contamination in inaccessible areas of Building 75A, warranting the designation of model code "E". Per discussions with DOE Headquarters, the sites are encouraged to use all available relevant information and guidance to supplement the AFDCS data call. However, additional guidance should not supersede the specific AFDCS guidance.

Although LBNL made the above designations with a conservative mindset, the interim liability was overstated by approximately \$165 million. However, LBNL corrected the errors before calculating the September 30, 2007 active facilities liability balance.

Recommendation:

11. We recommended that the Office of the CFO continue efforts to ensure the accuracy of the AFDCS data. The Office of the CFO should emphasize to the sites the importance of following the AFDCS guidance and that any additional relevant guidance should only supplement the AFDCS guidance.

Management Reaction:

Management concurs with the recommendation. The FY 2008 annual guidance will include additional information and emphasis on cost model determinations.

Finding 12: Inaccuracies in the Active Facilities Data Collection System (07-NST-AF-01)

Our detailed testing of 30 KCP facilities and structures from the AFDCS database identified nine errors in facility size that did not agree with the site's Computer Assisted Design (CAD) drawings. The following table shows recorded and revised size data for each of the nine facilities with identified errors:

COMMENTS

Gross Square Footage Exceptions:

Building #	Actual Size (sq. ft.)	Size Recorded in AFDCS (sq. ft.)	Difference (sq. ft.)	Amount Liability Understated
59	24,120	23,135	985	\$ 997,338
15	17,530	17,000	530	545,907
98	21,989	19,612	2,377	1,709,679
14	40,608	39,982	626	1,099,458
91	38,087	32,307	5,780	3,238,719
96	13,585	12,815	770	351,606
86	28,622	27,655	967	1,146,798
54	31,309	31,746	(437)	415,217
13	142,204	132,545	<u>9,659</u>	<u>7,164,093</u>
		Total	<u>21,257</u>	<u>\$16,668,815</u>

We also identified the following 11 KCP buildings whose footprint amounts in the AFDCS database did not agree with the CAD drawings.

Footprint Exceptions:

Building #	Actual Footprint	AFDCS Footprint	Footprint Difference	Amount Liability Understated
92	99,113	86,087	13,026	No Liability
59	21,967	11,568	10,399	***
15	14,040	8,512	5,528	***
88	29,619	17,998	11,621	\$ 610,529
98	21,989	9,806	12,183	***
14	34,198	18,377	15,821	***
91	23,714	10,769	12,945	***
86	22,496	9,302	13,194	***
54	20,980	9,914	11,066	***
13	127,027	66,024	61,003	***
1	1,431,743	582,420	<u>849,323</u>	<u>38,067,057</u>
		Total	<u>1,016,109</u>	<u>\$ 38,677,586</u>

*** KPMG noted both gross square footage and footprint exceptions for this facility. Please see the first table (*Gross Square Footage Exceptions*) for the liability understatement specific to each facility.

The majority of square footage exceptions resulted from improper measurements of gross square footage in KCP's CAD system. Several of KCP's CAD measurements incorrectly excluded equipment platforms. Other exceptions resulted from changes, such as the additions and removals of facilities, which were not updated in the AFDCS database. In addition, square footage of a corridor (MSB crossover) connecting two buildings was not included.

COMMENTS

Footprint differences were due to KCP not entering facility-specific footprint data into AFDCS. KCP uses FIMS to assist in tracking its active facilities, and FIMS does not have a footprint data field. As a result, KCP did not calculate specific footprint sizes for each multistory facility. Currently, the footprint amount for KCP's facilities in the AFDCS database is the default calculation of gross square footage divided by the number of floors. Our sample included multi-story facilities that had mezzanines, basements, and other smaller floors which when combined with the main floor level produced a footprint with significantly less square footage.

KCP understated its active facilities liability by approximately \$55 million. However, no adjustment to the liability is required as KCP corrected the errors prior to the final calculation of the liability.

Recommendations:

12. We recommended that the NNSA's Field CFO, and the Manager, Kansas City Site Office, direct Honeywell Federal Manufacturing & Technologies (Honeywell FM&T) to:
 - a. Ensure that data submitted to AFDCS by the KCP is accurate and complete;
 - b. Verify and update, as necessary, drawings currently maintained in Honeywell's CAD system;
 - c. Ensure that procedures provide for timely updating of data in the FIMS and AFDCS databases resulting from facility changes such as additions or deletions, and
 - d. Calculate the footprint of KCP multistory buildings using the size of the floor covering the greatest area and enter the data into AFDCS.

Management Reaction:

Honeywell FM&T concurs with the finding. Specific corrective actions taken to ensure accurate financial obligations are obtained using the AFDCS data base include:

- All building CAD files have been reviewed and gross square footage recalculated.
- Drawings and figures continue to be maintained within the Management and Operating contractor CAD model system as reviewed during the audit.
- CAD building model file reviews have been performed. There are no anticipated changes to buildings or the databases.
- All calculations have been updated in the KCP FIMS and AFDCS databases.

COMMENTS

**Finding 13: Inaccuracies in the Active Facilities Data Collection System
(07-NS3-AF-01)**

Our test of 30 facilities and structures selected from LLNL's AFDCS report identified four buildings for which LLNL had assigned incorrect facility model types. Three of the four facilities were designated as model type "F," denoting that the buildings are contaminated with both radiological and hazardous wastes and one facility was designated model type "G," denoting only hazardous waste contamination only. Discussions with the Associate Director Facility Managers (ADFM) disclosed that all four facilities should be designated the "no liability" (uncontaminated) model type, as defined by the AFDCS guidance.

Facilities 625, 614 & OS332WAA – Through discussions with ADFMs, historical and current use of these three facilities was to temporarily store various containerized waste sources. Some minor spills are on record for facility 614, but the spills were determined to have been completely remediated. For all three facilities, the ADFMs confirmed that if all containerized substances were to be removed, no contaminants would remain in the structures or systems of the facilities. Based on the AFDCS guidance, it was determined that the "no liability" model type is the most accurate designation for these three facilities.

Facility 423 – The ADFM for facility 423 advised that this facility was designated the hazardous contamination model type "G" because of significant asbestos being present in the facility's wallboard material. Although this facility will require special procedures and costs upon being demolished, the AFDCS guidance excludes asbestos-containing building materials from its definition of a contaminated facility. Based on this guidance, the "no liability" model type is most appropriate for this facility.

It was also noted that the Department is currently in a transition period regarding the treatment of asbestos contamination in the active facilities environmental liability. The Department has asked the sites to begin assessing their asbestos contamination and have begun adjusting the AFDCS to include the identification of asbestos. The Department plans to complete this transition and address asbestos contamination in AFDCS and in the active facilities cost model beginning in FY 2009.

The various individuals involved with designating and reviewing the LLNL facility model types were not aware of the specific exclusions detailed in the AFDCS definition of a contaminated facility.

As a result of the errors described above, the interim active facilities liability was overstated by approximately \$7.7 million. However, because testing occurred prior to year-end, LLNL was able to correct the errors prior to the final liability calculation, and thus, no adjustment to the active facilities liability is required.

COMMENTS

Recommendation:

13. We recommended that the NNSA's Field CFO, and the Manager, Livermore Site Office, direct LLNL to emphasize to ADFMs (or highlight in written procedures) that the definition exclusions exist to ensure that LLNL's facility cost model type assessments meet the specific guidance and definitions prescribed by the AFDCS.

Management Reaction:

Management concurred with the finding and will ensure that LLNL adheres to the specific guidance.

Environmental Safety and Health (ES&H) Liabilities

In estimating the Department's Environmental, Safety and Health (ES&H) liability, sites are to include those activities necessary to bring facilities and operations into compliance with existing environmental, safety and health laws and regulations. As directed by Departmental guidance, the FY 2007 estimate should consist of the total estimated costs of all compliance activities identified in each site's FY 2009 ES&H Management Plan or equivalent alternative. Furthermore, amounts reflected in the funded and unfunded compliance Activity Data Sheets should be summed for FY 2008 and beyond.

Finding 14: Audit Evidence Required for ES&H Compliance Liability Estimate (07-FT9-ESH-01)

The National Energy Technology Laboratory (NETL) management was unable to provide project by project documentation that supported the FY 2007 Beginning Balance of \$29,625,000 reported in the Department's financial system. In fact, no project-by-project specific documentation support could be located for ES&H compliance liability estimates reported in prior years, with the exception of the recording of \$13,387,000 in unfunded liabilities for four off-site projects in October 1993. The following Table shows the reported ES&H compliance liability reported by NETL to the Department in prior fiscal years according to accounting data.

End of Fiscal Year	Amount Reported
2000	\$46,000,000
2001	\$35,000,000
2002	\$29,000,000
2003	\$27,000,000
2004	\$25,500,000
2005	\$34,500,000
2006	\$29,625,000

While NETL does have financial records supporting the use of "Environmental Restoration" funding, NETL management was unable to provide a current ES&H

COMMENTS

Management Plan, or equivalent alternative, activity data sheet (ADS), or similar documentation. The most recent ES&H Management Plan and ADS information available is dated April 2003.

The lack of project-by-project specific documentation to support the baseline figure from which FY 2007 cost/obligations (Environmental Restoration funding) were deducted makes the third quarter balance estimate of \$26,818,178, as of June 30, 2007, uncertain and prohibits auditor verification of NETL's reported ES&H liability estimate as accurate, current, or complete. Just as significant, the lack of the project-by-project specific documentation does not allow NETL to determine if the Environmental Restoration funds were used for identified projects.

NETL does not have an official process to ensure that ES&H data is collected, updated, and transmitted, either accurately or in its entirety, for inclusion in the financial statements. Management's inexperience with NETL's ES&H liabilities estimates appears to have contributed to the lack of documentation supportive of the reported baseline figure. Two individuals responsible for overseeing the development of the ES&H liability estimate have each held their current position for less than one year.

NETL's ES&H Liability of \$26,818,178, as of June 30, 2007, can not be verified and may be under- or over- reported; thereby, resulting in an inaccurate ES&H liability reported on the Department's consolidated financial statements.

Recommendations:

14. We recommended that the Director, NETL direct the Director, Office of Institutional and Business Operations, to:
 - a. Establish a project-by-project listing of efforts required to ensure ES&H compliance and perform a cost analysis for each project reporting an ES&H liability to ensure an accurate estimate; and
 - b. Develop and implement a process with the controls necessary to ensure ES&H data is verifiable and required documentation is retained.

Management Reaction:

NETL concurs with the recommendations provided by the auditors. NETL will identify all projects for which we have an ES&H compliance liability and will provide a cost analysis for each identified project to bring it into compliance with all applicable ES&H rules, regulations, and DOE directives. The projects will be identified to the auditors by September 30, 2007. The cost analysis, which we understand will be subject to acceptability as to reliability (certifiability) by the auditors, will be provided by September 30, 2007. In the event that the cost analysis (i.e., the cost to comply) is not considered reliable, we will work with the auditors to comply with the recommendation by December 31, 2007.

COMMENTS

NETL will develop and implement a process with the controls necessary to ensure ES&H data is verifiable and required documentation is retained which is acceptable to the auditors.

Inventory

Finding 15: Inventory Observation (07-NST-OI-01)

A randomly selected sample of 15 small stores inventory items at the KCP disclosed a shortage of on-hand quantities for two items with a net value of \$208, and also three items with an excess of on hand quantities with a net value of \$128. The net result of these five exceptions was an overstatement of \$80.

Adequate controls were not in place to ensure that quantities on hand agreed to the quantities recorded in the accounting records at KCP. This was likely due to a combination of the following causes:

- A miscount of an item during a periodic inventory;
- The removal of an inventory item without recording its removal (e.g., inventory clerk may have been inundated with supply stores item requests and neglected to record the issuance of certain items); or
- Inventory records not periodically reviewed and reconciled.

According to Honeywell FM&T personnel, the three exceptions in which the observed quantity exceeded the quantity per the accounting records (or books) were likely due to these items being checked out as spare parts assigned to a particular job, were not used for that job, and subsequently returned without being properly entered back into the system.

As a result of the differences in quantities observed compared to quantities actually on hand, the inventory at KCP had a net overstatement of \$80.

Recommendations:

15. We recommended that NNSA's Field CFO, and the Manager, Kansas City Site Office, direct Honeywell FM&T to:
 - a. Correct the accounting records for the differences noted on the above items, and
 - b. Develop and implement a procedure to ensure that stores inventory quantities on hand agree to the quantities in the accounting records.

COMMENTS

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Adjustments have been made to the inventory accounting records to correct the quantities for the items noted above. Honeywell FM&T has policies and procedures in place to help ensure the accuracy of inventory records.

Additionally, during FY 2008, Honeywell FM&T plans to review financial controls over the other inventory in accordance with the ongoing 3-year cyclical requirements of OMB Circular A-123. If weaknesses are identified, corrective actions will be implemented.

Finding 16: Boron Valuation (07-NST-OI-02)

Management at the KCP could not provide adequate documentation to support the recorded cost of its Boron inventory, which is about \$25 million or 74 percent of the value of the site's Other Inventory balance. Management advised that the Boron inventory was recorded at historical cost, but could not provide invoices or purchase orders to support the cost. The site did, however, provide a listing of journal entries to support recording \$20,145,472 of the inventory, leaving an unsupported balance of \$4,992,689. Site officials stated that the KCP had not purchased Boron in the last 10 to 12 years.

The KCP could not locate a folder that purportedly contained the Boron cost information. The KCP has an extensive inventory listing, over 15,000 item types, with a value in excess of \$34 million. It also has hundreds of thousands, if not millions, of individual inventory items in multiple storerooms with multiple attendants. Per KCP personnel, maintaining complete, accurate inventory records under such conditions has been difficult. Further, Boron is not purchased regularly, and the last purchase was made before the current software that tracks purchases and receipts was in place.

As a result, the KCP's Boron inventory may not be valued correctly, thereby overstating or understating the recorded value of Other Inventory.

Recommendations:

16. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, and the Manager, Kansas City Site Office, direct the Kansas City Plant to:
 - a. Establish a reasonable supportable estimated value of its current Boron inventory, possibly using data from recorded historical purchases, and
 - b. Strengthen controls, as necessary, to ensure the retention of documentation supporting the costs of its boron inventory.

During the audit field work 80% of the Boron value was supported as referenced in the finding. Since the period of field work, KCP has obtained historical documentation supporting the remaining 20% balance (reference table below). Delayed response was due to pulling and reviewing records from records retirement (applicable period is 10 to 20 years old) prior to the current PeopleSoft system. The FY 1999 financial statement audit was also reviewed as it was the year of the PeopleSoft implementation.

KCP has reviewed historical documents and validated the existing inventory value.

Amount	Valuation
\$20,145K	Value referenced in the finding reflecting purchase order procurements from 1985 to 1995 for one part number. Current weighted average standard cost was developed in August 1996.
\$493K	Remaining quantity on the one part number priced at the weighted average of the procurements from 1985 to 1995.
\$2,948K	Value on remaining part numbers based on standard cost identified in August 1996 internal stores account reports (R3028x18 report).
<u>\$1,542K</u>	Classified parts based on standard cost identified in August 1996 internal stores account reports.
<u>\$25,128K</u>	Total May 2007 Inventory Value

The basis for the \$25.1 million Boron inventory consists of \$20.6 million derived from a summary of purchase orders from 1985 to 1995 and \$4.5 million from internal stores reports referencing the existing standard cost in 1996. These were the existing standards at the time of the PeopleSoft conversion.

The Boron purchases were made prior to the 1999 implementation of PeopleSoft. Since historical purchase order information was not retained in the legacy system, the value assigned to these items to calculate the weighted average standard was the item standard at the time of conversion. KCP reviewed this inventory valuation methodology with KPMG and the Inspector General during the FY 1999 GMRA financial statement audit and it was accepted for Production Inventory (1).

With the added documentation of the legacy standard cost at the time of conversion and the stability in the boron inventory balance since FY 1999, the historical records adequately support the ledger valuation.

COMMENTS

1 *Reference is made to the following documents from the FY 1999 financial statement audit: May 2000 Audit Report, Report on matters identified at the Albuquerque Operations Office during the audit of the DOE's Consolidated FY 1999 Financial Statements; Memorandum from the Office of Inspector General to the Director Albuquerque Financial Service Center, dated January 7, 2000; subject: Audit Issues on AlliedSignal Finding NM-1R; Finding NM-1 Nuclear Materials Inventory – Inventory Valuation Should Approximate Historical Cost, dated December 17, 1999; Finding NM-2 Nuclear Materials Inventory – Inventory Valuation Allowance, dated October 29, 1999.*

2. *Establish controls to ensure the retention of documentation supporting the costs of its Boron inventory.*

The finding inaccurately references positions from KCP management under the CAUSE section, *'The Kansas City Plant management indicated that a lapse of control over invoice documentation contributed to the missing supporting documentation for the Boron inventory.'* Management did not make these statements as implied in the finding. The following controls are in place:

Documentation supporting Inventory Cost: The basis for the \$25.1 million boron inventory consists of \$20.6 million derived from a summary of purchase orders from 1985-1995 and \$4.5 million from internal stores reports. Each source reflects the existing standard cost in 1996 and at the time of the PeopleSoft conversion. The conversion standard for legacy procurements has been an accepted methodology since the FY 1999 financial statement audit, as discussed in the first recommendation. With the implementation of the PeopleSoft Enterprise Resource Planning system in 1999, the integrated system tracks purchases, receipts and historical transactions are available within the system. Purchase order documentation is maintained for 7 years as normal retention practices in accordance with Records Inventory & Disposition Schedules process.

Inventory Controls: The Boron inventory is coordinated by Finance and conducted annually over the course of 2 weeks; variances have been minor. Complete, accurate inventory records are being maintained as validated by the annual inventory process and associated results.

Additional information has been provided in response to the subject finding. This information resulted from pulling and reviewing records from records retirement (applicable period is 10 to 20 years old) prior to the current PeopleSoft system. If after review of this information the Inspector General believes a lapse of control exists, then KCP requires a more detailed explanation of the control weakness within the context of generally accepted accounting principles supporting the financial statements.

Auditor Comments:

We appreciate management's response; however, the finding will remain open until we can perform follow-up procedures in FY 2008 to evaluate whether the documentation that

COMMENTS

KCP located, after our test work was completed, provides adequate support of the historical cost of the inventory. Regarding the second recommendation, we have modified the cause paragraph to remove the first sentence concerning lapse of control over invoice documentation contributed to the missing supporting documentation for the Boron inventory. We have also modified our recommendation to suggest that management strengthen, rather than establish, controls.

Finding 17: September Activity in Nuclear Materials Inventory (07-NS1-NM-01)

During our review of LANL's Pit Production accounting, we noted that LANL personnel did not make the necessary entry to record the September 2007 activity in the nuclear materials inventory until October 2007, after LANL closed its accounting records for the fiscal year ended September 30, 2007. LANL tracks the inventory related to weapons development, nuclear materials, and pit production, in detail within a classified system. Because there is no electronic connection between the classified system and the unclassified system, on a monthly basis, the inventory activity is summarized into an entry that adjusts the inventory balance in the general ledger for the net change in the classified system.

LANL personnel stated that there was not sufficient time during year-end closing procedures to accumulate the information and make the necessary entry. As a result, LANL understated its September 30, 2007 nuclear materials inventory balance and overstated the costs associated with the Pit Production program by \$1.6 million.

Recommendation:

17. We recommended that NNSA's Field CFO, in conjunction with the Manager, Los Alamos Site Office, direct LANL to establish controls to ensure the timely recording of nuclear material inventory activity in the general ledger within the appropriate accounting period.

Management Reaction:

Management partially agreed with the recommendation, but indicated that it cannot establish controls that override national security considerations. Management's comments follow:

The data related to the \$1.6 million was a capitalization entry in connection with September 2007 Weapons activity. Pit Manufacturing/Production had a deadline of September 30th to meet and their information was classified until completion, shipment and receipt of the final product. It would have been a security incident related to national security if this information was provided prior to that time and consequently the information was not provided to Finance until after September 30th. In any conflict between accounting/financial requirements and classified data/national security issues, we recognize that national security takes precedence and that some of the financial and

COMMENTS

accounting information cannot be provided prior to completion or shipment and receipt, especially since this dollar amount is immaterial to LANL's overall asset balance.

We cannot set up controls in Finance that override national security considerations; however, we agree to work with Pit Manufacturing/Production to examine those controls and look at alternate methods of recording the necessary information in the general ledger or Standard Accounting and Reporting System (STARS).

Auditor Comments:

The inventory discussed in this finding relates to all LANL's inventory related to pit production, including raw materials and finished products. Our audit procedures disclosed that the information to properly record most if not all the September activity related to pit production was available by the year-end closing date. In our recommendation we are not suggesting that accounting override national security, but that once the information is available for making the necessary accounting entries that those entries are recorded timely, especially at year-end.

Finding 18: Obsolete Inventory (07-NS1-NM-02)

During our review of LANL's nuclear materials inventory detail, we noted two inventory part numbers where LANL personnel included "items to be scrapped" in the comment section next to the part. The recorded book value of the two inventory items was approximately \$80,000.

During the year, a new individual has taken over the accounting for Pit Production and the nuclear materials inventory. The individual stated that she does not know the exact status of the items and has been trying to contact the appropriate inventory custodians in order to determine the reason(s) for the notations and if the inventory needs to be adjusted through an allowance or write-off.

If these items are obsolete or unusable, then LANL has overstated its inventory as of September 30, 2007, by \$80,000.

Recommendations:

18. We recommended that NNSA's Field CFO, in conjunction with the Manager, Los Alamos Site Office, direct LANL to:
 - a. Take necessary actions to determine if the inventory balance in the general ledger needs to be adjusted for these two inventory items, and
 - b. Ensure that in the future, inventory balances are properly adjusted for any excess, obsolete, or unserviceable inventories.

COMMENTS

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Management stated that the inventory should be adjusted for both of

This appears to be an anomaly due to one-time systems issues associated with migrating from the IFS system to MRP. Management agrees with both parts of the recommendation, although the first part of the recommendation should read “determine amount adjusted” rather than “determine whether...”. The general ledger will be adjusted for these two items as soon as possible. Regarding the second part, management agreed to review the desk procedures governing the area and strengthen them, if necessary.

Property, Plant, and Equipment

Background: Property, Plant, and Equipment (PP&E) are tangible assets acquired or constructed by an entity to be used, or available for use, to produce goods, services, and support for the entity’s mission.

The Office of Financial Policy, through the Office of CFO, issued the Department’s *Accounting Handbook* on October 17, 1995. The purpose of the *Accounting Handbook* is to present the Department’s standards, procedures, and operational requirements in support of the accounting policies, principles, and applicable legal requirements. It also provides general guidance for accounting and financial management policies for functions and responsibilities not otherwise covered, and that may be unique to the Department. The provisions of the *Accounting Handbook* apply to all Departmental elements and integrated contractors performing work for the Department as provided by law or contract as implemented by the appropriate contracting officer. The Department owns many government facilities and laboratories operated by management and operating contractors. The Department refers to most of its management and operating contractors as “integrated” contractors because their financial systems are integrated with the Department’s financial systems. Nonintegrated contractors are also required to follow the applicable standards and procedures as specified in the *Accounting Handbook*, if provided in their contracts.

Finding 19: Gain/Loss Recognition on Disposal of Fixed Assets (07-CH2-PPE-01)

A sample of nine current year fixed asset disposals at Argonne National Laboratory (Argonne) disclosed that two assets were retired with a remaining net book value. The

COMMENTS

entry to remove the net book value from the books was ultimately mapped to a "depreciation" account (SGL 67100100) in STARS, rather than a "loss on disposition" account (SGL 7XXXXXXX) as required by SFFAS No. 6 and Departmental policies.

The Department implemented a new financial accounting system, referred to as STARS, in April 2005. According to site personnel, the mapping from Argonne's financial system through the earlier system and ultimately to STARS was set up at that time and did not consider the distinction on the financial statements of recording losses on disposition.

There is no effect on the Department's overall net position or on Argonne's stand alone financial statements; however, Argonne continues to report its financial results to the Department incorrectly.

Recommendation:

19. We recommended that the Manager of the Argonne Site Office direct responsible personnel in Argonne's Department of the CFO to work with the appropriate accounting personnel in the Chicago Office and/or at Department Headquarters to re-configure the STARS mapping routine to ensure that any difference between the recovered value and the net book value of retired assets is recorded to the proper account so that the gain or loss is appropriately recognized.

Management Reaction:

Management agreed with our findings and its comments and has discussed it with the Argonne. Management stated that Argonne's Department of the Chief Financial Officer has already reconfigured the STARS mapping routine for fixed assets as stated in the recommendation and the change will be reflected in the September financial records.

Finding 20: Gain/Loss Recognition on Disposal of Fixed Assets (07-CHF-PPE-01)

A sample of nine current year fixed asset disposals at the Fermi National Accelerator Laboratory (Fermi) disclosed that one asset was retired with remaining net book value. The entry to remove the net book value from the books was ultimately mapped to a "depreciation" account, Standard General Ledger (SGL) account number 67100100, in the STARS rather than a "loss on disposition" account, SGL#7XXXXXX, as required by SFFAS No. 6 and Departmental policies.

The Department implemented a new financial accounting system, referred to as STARS in April 2005. According to site personnel, the mapping from Fermi's financial system through the earlier system and ultimately to STARS was set up at that time, and did not consider the distinction on the financial statements of recording losses on disposition.

There is no effect on the Department's overall net position or on Fermi's stand alone financial statements; however, Fermi continues to report its financial results to the Department incorrectly.

COMMENTS

Recommendation:

20. We recommended that the Manager of the Fermi Site Office direct responsible personnel in Fermi's Department of the CFO to work with the appropriate accounting personnel in the Chicago Office and/or at Department Headquarters to re-configure the STARS mapping routine to ensure that any difference between the recovered value and the net book value of retired assets is recorded to the proper account so that the gain or loss is appropriately recognized.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. The Fermi Contracting Officer has met with the Fermi CFO to discuss the recommendation and the path forward. Fermi Accounting has discussed the matter with the DOE Chicago Office. Since the SGL Crosswalk on the I-Manage website does not contain an entry to crosswalk gains/losses appropriately, Fermi stated it has implemented a monthly manual adjustment for such transactions. A manual adjustment for FY07 gains/losses was included in the September 2007 STARS file. Fermi stated it will also work to re-configure their internal STARS mapping routine to ensure that any difference between the recovered value and the net book value of retired assets is recorded to the proper account so that the gain or loss is appropriately recognized. This activity will be completed by March 31st, 2008.

Finding 21: Timeliness of Capitalization (07-CHF-PPE-02)

A test of 21 current year fixed asset additions at Fermi disclosed that two additions (Project Nos. 19A and 23C) had a long delay (approximately one year) between the time the assets were placed in service and the time the assets were transferred to completed plant and capitalized in the accounting system.

Management indicated that the assets we selected for test work were part of larger projects that were reviewed by the Division Financial Managers after the projects were completed. Once the projects were completed, the Division Financial Manager reviewed each major component and provided information which included more appropriate acquisition ("placed in service") dates. As a result, the "acquisition dates" used to compute depreciation expense were revised and all prior year depreciation which should have been recorded was "caught up" in the current fiscal year.

The Fermi Accounting Department recorded "catch-up" depreciation for the prior fiscal year during FY 2007. Because of the delay from the time the assets were placed in service and the time the assets were capitalized, Fermi understated its completed PP&E and overstated Construction Work-in-Process (CWIP) by \$775,472 (amounting to \$583,536 for Project 19A, and \$191,936 for Project 23C) as of September 30, 2006.

COMMENTS

In addition, Fermi understated depreciation expense and accumulated depreciation by three months of depreciation amounting to \$9,693 in FY 2006 and correspondingly overstated depreciation expense by the same amount in FY 2007 (the sum of \$7,294 for Project 19A and \$2,399 for Project 23C).

CWIP, completed PP&E, and accumulated depreciation are correct for FY 2007.

Recommendation:

21. We recommended that the Manager of the Fermi Site Office direct responsible personnel in Fermi's Department of the CFO to implement effective procedures requiring Fermi Project Management to report asset acquisition dates either when acquired or, if constructed, when placed into service.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. The Fermi Contracting Officer has met with the Fermi CFO to discuss the recommendation and the path forward. Fermi stated that in response to findings from Universities Research Association's independent auditors in FY 2006, it has worked to improve the timeliness of capitalizations throughout FY 2007. Fermi further stated that the finding herein, as well as its own analyses, shows there are further improvements to be made. Fermi further stated that it will be instituting procedures in FY08 that will require identification of final capitalizable assets and estimated completion dates at the time equipment funds are budgeted to a Division/Section/Center. Segregation of discrete assets in the accounting system will also be required. In addition, Accounting will document the inventory of all equipment work in process balances, including the estimated completion date for each asset in process. These actions are expected to assure the timely capitalization of work-in-process assets in FY08 and beyond.

Finding 22: Unidentifiable Assets Capitalized (07-CHF-PPE-03)

A test of 21 current year asset additions disclosed that Fermi capitalized one asset amount (Tag PA0001) \$575,312 which could not be identified with any specific asset placed in service. The amount related to a work in progress balance that existed after an accounting records conversion in a prior year. Further review disclosed that Fermi had capitalized two other similar balance amounts (another amount for Tag PA0001 and Tag CP0001) related to the conversion but were not included in our sample. The account balances for the three items lost their identity to a project when Fermi converted its accounting records to the project accounting based system in FY 2003. Without matching the amounts to specific assets, Fermi cannot transfer, retire, or otherwise take such assets out of service.

Fermi officials believed that the amounts represented valid equipment assets placed in service before the 2003 conversion date and transferred the amounts to completed plant in FY 2007 to "clean up" the work in progress accounts. Fermi believed these amounts

COMMENTS

were the only ones related to this issue and that it has identified the depreciation effects related to each.

The net effect of the transferred amount for our sample item for Tag PA0001 is \$80,193 representing an overstatement of the Property and Equipment account of \$575,312, less the related depreciation taken through June 30, 2007.

The net effect of the other amounts not included in our sample representing overstated Property and Equipment balances follow:

Tag PA0001 – A net amount of \$118,211 representing a capitalized amount of \$830,700 less the related depreciation taken through June 30, 2007.

Tag CP0001 – A net amount of \$84, 623 representing a capitalized amount of \$604,448 less the related depreciation taken through June 30, 2007.

The total incorrectly capitalized amounts resulted in Fermi overstating the net Property and Equipment account by \$283,027 as of June 30, 2007.

Recommendation:

22. We recommended that the Manager of the Fermi Site Office direct Fermi to remove the asset amounts which cannot be identified with specific physical equipment from the capital asset accounts reported to DOE.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. In September 2007 Fermi wrote-off the capitalization of the unidentified assets and related depreciation.

Finding 23: Inaccurate Property Costs (07-NS3-PPE-01)

A test of 21 current year PP&E additions at the LLNL disclosed that the cost of one asset was overstated and the costs of two assets were understated in LLNL's property and financial records.

Property # 8898324 – LLNL Property Accounting personnel included \$35,000 of training and maintenance support in the cost of this property. SFFAS No. 6 does not list training and maintenance support as a cost of property. Generally, training and maintenance support costs are expensed when incurred.

Property # 8881081 – LLNL Property Accounting personnel did not include shipping charges of \$3,188 related to this asset. SFFAS No. 6 states that transportation costs may be included in the asset's cost.

COMMENTS

Property # 8887411 – LLNL Property Accounting personnel did not include a Material Processing Charge of \$20,928 related to this asset. LLNL considers the charge a handling cost essential to the asset's acquisition. SFFAS No. 6 states that handling costs may be included in the asset's cost.

LLNL's Property Accounting department agreed that the property cost differences that we identified were user errors, and that they should correct the costs.

The incorrect property costs resulted in a \$10,884 net overstatement of LLNL's interim general PP&E balance. However, LLNL recorded adjusting entries to correct the recorded property costs prior to September 30, 2007.

Recommendation:

23. We recommended that the NNSA's Field CFO, and the Manager, Livermore Site Office, direct LLNL to emphasize to staff in its Property Accounting department the importance of accurately determining and recording the correct cost of PP&E in the property and financial records.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. The Livermore Site Office will direct LLNL to emphasize the importance of accurately determining and recording the correct cost of PP&E in its property and financial records.

Finding 24: Construction-In-Process (07-NS9-PPE-02)

Unmonitored CIP - As of June 30, 2007, the NNSA Service Center's (Service Center) Construction-In-Process (CIP) account contained an estimated 46 projects totaling approximately \$97 million with no or minimal activity in FY 2007. Of the \$97 million in CIP, the Service Center determined that \$19 thousand should be transferred to general PP&E and depreciated; and \$2.2 million should be transferred out of CIP and expensed. The remaining balance of approximately \$95 million remains undetermined as to the projects status.

Service Center project management personnel are not notifying Property Accounting of completed projects timely. Additionally, as of June 30, 2007 there has been no formal monitoring of NNSA's CIP accounts.

Due to the backlog of unmonitored CIP projects, the Service Center cannot easily identify which projects are complete and require transfer out of CIP to general PP&E accounts and which projects are still active. This also limits NNSA's ability to determine the asset acquisition or "in service" date in order to subject the asset to depreciation. As of June 30, 2007, NNSA has overstated CIP and understated general PP&E, accumulated depreciation, and depreciation expense in the current and prior years.

COMMENTS

Premature Capitalizations of CIP - A test of 21 current year NNSA asset additions disclosed four improper capitalizations of CIP costs, as follows:

CID	Description	Amount
SF19460	University of Rochester	\$158,306
SF19460	University of Rochester	\$400,000
SF19460	University of Rochester	\$960,000
SF19460	University of Rochester	\$10,126

The costs noted above relate to the construction of a laser by the University of Rochester. Upon completion of the laser construction, the asset will be operational and title will reside with the Service Center. As of June 30, 2007, the equipment was still in the construction phase; therefore, the costs should have been reported in CWIP.

The Service Center acquired the University of Rochester Laser project from the Oakland Office when the Department transferred certain accounting responsibilities from the Oakland Office to the Service Center. The Oakland Office had capitalized the laser project prior to its transfer to NNSA. NNSA capitalized additions to this project upon transfer because the project did not originate with the Service Center.

The laser project capitalizations resulted in the Service Center overstating general PP&E and understating CIP by approximately \$1.3 million. Capitalizing the construction costs prematurely overstated depreciation expense and accumulated depreciation by approximately \$290 thousand.

Recommendations:

24. We recommended that the NNSA's Field CFO direct NNSA personnel to:
 - a. Enforce procedures requiring that the NNSA Service Center's project management personnel provide timely notice to Property Accounting when a project is completed and placed into service;
 - b. Establish policies to properly monitor CWIP activity; and
 - c. Establish policies to ensure that construction projects are not capitalized prior to being placed into service.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. NNSA stated they have established a process to monitor CIP and assure that timely final cost reports are received by NNSA – Office of Field Financial Management (OFFM) from project managers in order to capitalize them as they are placed in service. NNSA will continue to work with DOE Headquarters – Energy

COMMENTS

Finance and Accounting Service Center (EFASC) on policies to ensure that items will not be capitalized prematurely.

Finding 25: Inaccurate Property Costs (07-NS9-PPE-01)

A test of 21 current year PP&E additions at the NNSA Service Center disclosed that two additions related to research and development (R&D) activity and not capital assets acquisitions. Financial accounting standards provide that R&D costs should be charged to expense when incurred.

CID	Description	Costs
NA27279	General Atomics	\$722,351
NA27279	General Atomics	\$15,033

At the inception of the contract, all R&D costs were coded with an object class of 3100, which is the driver behind the capitalization of these costs. Additionally, contracting officers in certain instances stated within the contract terms that certain research and development costs are to be capitalized.

General PP&E was overstated by approximately \$737,000 due to the improper accounting for R&D expenditures. Additionally, depreciation expense and accumulated depreciation expense were overstated.

Recommendation:

25. We recommended that the NNSA's Field CFO, in conjunction with the Department's Headquarters establish policies to ensure research and development costs are expensed as incurred.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. NNSA's OFFM will contact the Department Office of Financial Policy, CF-50 for guidance/policy on the proper treatment for research and development costs and related PP&E.

Finding 26: Retroactive Depreciation Expense (07-XN9-PPE-01)

The Department's EFASC procedure for calculating and recording depreciation, in certain cases, was not consistent with the requirements of SFFAS No. 6 and the DOE *Accounting Handbook*. In some circumstances, EFASC records the cost of additions to existing assets as part of the original asset. When EFASC records an addition as part of the existing asset, the fixed asset system re-calculates accumulated depreciation using the original asset's in-service date and useful life. The system records accumulated depreciation and depreciation expense on the asset additions cost retroactively to the date that the original asset was placed in service instead of recording the costs over the remaining useful life of the asset.

COMMENTS

Our testing of depreciation expense on a sample of 21 NNSA property additions during FY 2007 identified one asset totaling \$10,000, in which the system calculated depreciation based on the original asset's acquisition date.

The method used to record additions to existing assets has been in place since the Department converted to the STARS system in FY 2005.

EFASC recorded, on NNSA's behalf, excess depreciation of approximately \$714 in FY 2007 for the asset noted above. It was determined that EFASC made \$8.1 million in FY 2007 additions to existing assets through August. EFASC recorded retroactive depreciation on these additions. The use of this method will overstate accumulated depreciation and understate depreciation expense in all future periods, until the asset is fully depreciated.

Recommendation:

26. We recommended that the Department's CFO, in conjunction with EFASC, evaluate alternative ways to record additions in the STARS Fixed Assets Module, so that their process is consistent with the requirements of SFFAS No. 6 and the *DOE Accounting Handbook*. More specifically, additions to existing assets should be capitalized and depreciated prospectively over the expected useful life of the existing asset or for the period of time that the addition extends the useful life of the original asset.

Management Reaction:

Management's decision to process all asset additions as adjustments was based on the expected costs and the minimal benefits of making case-by-case determinations on how individual asset transactions should be treated. The net impact on depreciation expense and accumulated depreciation for FY 2007 was \$1,375,521 and was immaterial to depreciation expense (\$194,747,155), accumulated depreciation (\$4,796,206,632), and completed asset balances (\$5,355,889,679). We agree with the finding that all additions to completed assets were treated as adjustments and subject to accelerated depreciation. We will re-evaluate the costs and benefits of alternative ways to record additions in the STARS Fixed Assets Module.

Finding 27: Inaccurate Account Balance (07-XN9-PPE-02)

Year-end audit procedures identified a significant fluctuation and an abnormal account balance in the NNSA Service Center's depreciation account (SGL account 6710). Response to audit inquiry disclosed a duplicated adjusting journal entry processed through the fixed assets module.

An interim audit finding regarding premature capitalization of construction in process items selected for test work resulted in NNSA conducting research into similar

COMMENTS

transactions and identified the need for corrections to the fixed asset records. An inappropriate SGL account entered by EFASC for one of the correcting journal entries caused the fixed assets module to duplicate the entry.

The duplicated entry overstated the net property account and understated the depreciation expense accounts by \$82.5 million. However, EFASC, with the assistance of the Office of Financial Oversight, recorded an audit adjustment as of September 30, 2007 to correct this error for the purposes of the September 30, 2007 consolidated financial statements.

Recommendation:

27. We recommended that the Department's CFO, in conjunction with EFASC, continue to ensure that entries processed through the fixed assets module are appropriate and supported. This should include reviewing non-routine journal entries for reasonableness and analyzing any resulting abnormal balances.

Management Reaction:

We concur with the finding and recommendation and will continue to ensure that entries processed through the fixed assets module are appropriate and supported.

Payroll

Finding 28: Updated Life Insurance Withholding (07-NS9-HR-01)

One NNSA employee's withholding for a life insurance premium under the Federal Employees Group Life Insurance (FEGLI) program was inaccurate. We found that the employee elected FEGLI Basic, as well as Options A and B for one multiple of coverage on *Life Insurance Election*, Standard Form (SF)-2817. However, the employee's withholding was based on information in his SF-50, *Notification of Personnel Action*, which indicated that he elected Basic, as well as Option A and Option C for one multiple of coverage. Based on the payroll information from the Defense Finance and Accounting Service used to process the Department's payroll, a premium of \$20.55 is withheld from the employee's pay each pay period. However, our audit showed that since May 2005, the effective date of the employee's coverage, the amount of the withholding should have been \$31.20. This under-deduction of \$10.65 per pay period has occurred for 37 pay periods as of the pay period we tested, resulting in a deficit of, \$394.05 in additional withholdings that should have been made.

Due to an administrative error by the NNSA Office of Human Capital Management Services, the information in the SF-2817 was recorded in error. We referred this error to the NNSA Office of Human Capital Management Services, which indicated that the error would be corrected.

The error appeared to be a simple oversight, and we have no indication of a significant weakness in controls that could have an adverse affect on Payroll expenses.

COMMENTS

Recommendation:

28. We recommended that the NNSA Office of Human Capital Management Services correct the employee's life insurance election and ensure that the proper amount is withheld from the employee's pay.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. An exact copy of the corrected Standard Form 50, Notification of Personnel Action, effective date retroactive to May 15, 2005, which was the date of the initial error, was provided after issuance of finding. In addition to the corrective action the employee was notified of the error which will result in an additional amount owed to the Federal government. The employee was also informed that he would be notified by the Defense Financial Accounting Service (DFAS) in regards to repayment.

Finding 29: Updated Health Benefit Withholding (07-XN9-HR-01)

One Office of Energy Efficiency and Renewable Energy employee elected to change Health Benefit Plans and submitted the required SF-2809, *Health Benefits Election Form*, to do so. We observed that the employee elected to change from Federal Employee Health Benefits (FEHB) Blue Cross Blue Shield Plan 112 to Blue Cross Blue Shield Plan 105 on December 10, 2002, as evidenced by a signed SF-2809 in the employee's Official Personnel File. However, this change was never processed, resulting in an incorrect FEHB withholding amount. Based on the payroll information from Defense Finance and Accounting Service used to process the Department's Federal payroll, the following table shows the error in the amounts withheld.

<u>Year</u>	<u>Code 112</u>	<u>Code 105</u>	<u>Difference</u>	<u>#of Pds</u>	<u>Amount Under-Deducted</u>
2006	\$88.99	\$135.59	\$46.60	20	\$932.00
2005	\$88.99	\$118.06	\$29.07	26	\$755.82
2004	\$88.99	\$112.88	\$23.89	26	\$621.14
2003	\$82.27	\$105.22	\$22.95	26	\$596.70

These differences had been in effect for 98 pay periods as of the pay period we tested. In total, \$2,905.66 in additional withholdings should have been made.

Due to an administrative error by the Headquarters Human Resources Operations Division, the information in the SF-2809 was never processed. We referred this error to the Headquarters Human Resources Operations Division, which indicated that the error would be corrected.

The error appeared to be a simple oversight, and we have no indication of a significant weakness in controls that could have an adverse affect on Payroll expenses.

COMMENTS

Recommendation:

29. We recommended that the Headquarters Human Resources Operations Division correct the employee's FEHB enrollment and ensure that the proper amount is withheld from the employee's pay.

Management Reaction:

Management concurs with the recommendation and has reviewed the error, but cannot determine the specific reason the form was not processed. Based on concurrence from the Office of Personnel Management, which administers the Health Benefits program, the Headquarters Human Resources Operations Division will process the change in the Blue Cross coverage from code 112 to 105, effective July 22, 2007. The payroll system will automatically deduct the correct amount based on the new code. The change in premiums for the new coverage will be effective on July 22, 2007, and there will be no retro-active premiums due from the employee.

Finding 30: Time Card Approval (07-NSH-HR-01)

A test of 30 Sandia National Laboratories (Sandia) payroll transactions disclosed that each of the three Department Managers in the sample self-approved their time cards, thus negating the internal control feature related to separation of duties. Sandia personnel explained that Department Managers have always approved their own time cards, and pointed out that Sandia's internal policy, referred to as Corporate Process Requirements (CPR 001.4.1), allows it. NNSA personnel at the Site Office and the Service Center, however, were not aware of the authorization provided in Sandia's policy and stated that both the Site Office and the Office of Field Financial Management can question Sandia policies and recommend changes to the Contracting Officer. They believed that self approval of time cards weakened Sandia's system of internal controls and increased the chances for undetected errors.

NNSA does not have a clearly defined process to review and question Sandia's new or revised Corporate Process Requirements. At present, Sandia's lack of a segregation of duties related to its policy on time card approval gives Sandia questionable control over the allocation of effort by Sandia's Department Managers.

Inadequate controls over time card authorizations increase the potential for misallocation of time between Department effort and reimbursed effort on work for other entities. Sandia records show that Department Managers and above make up nearly 10 percent of Sandia's total workforce, thus, the potential misallocations could be significant.

COMMENTS

Recommendations:

30. We recommended that NNSA's Field CFO, in conjunction with the Manager, Sandia Site Office:
 - a. Clearly define the process, including roles and responsibilities to review and approve Sandia's Corporate Process Requirements, as necessary, and
 - b. Require Sandia to change its policy to eliminate a Department Manager's authority to self approve time cards.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. NNSA stated that in response to recommendation one, it has developed processes and responsibilities that evaluate the systems utilized by the contractor to process accounting information that is then passed on to their system. NNSA also stated it has an extensive A-123 process that evaluates the controls of each contractor. In response to recommendation two, NNSA stated it will evaluate the SNL labor practice and ensure that the controls over approval are consistent with the expectations on its other contracts.

Finding 31: Payroll Withholding Authorization (07-NSH-HR-02)

A test of 30 Sandia payroll transactions including miscellaneous payroll deductions disclosed that Sandia deducted union dues from an employee's pay without obtaining authorization from the employee.

The Payroll Department wanted to avoid making retroactive adjustments to the employees pay after the authorization card was received, Payroll personnel were able to deduct union dues from the employee's pay before they received authorization because Sandia did not have a written policy preventing this action. The deduction start date for union employees is the employee's hire date plus 30 days, regardless of when the deduction authorization card is received. Authorization cards are not always received in a timely manner; therefore, deductions of union dues can accumulate into large amounts if the retroactive adjustment occurs in one pay period. In this instance, the deduction authorization card was not received by the Payroll Department timely.

Sandia withheld \$186 from an employee's pay in FY 2007 without proper authority.

Recommendation:

31. We recommended that NNSA's Field CFO, in conjunction with the Manager, Sandia Site Office, direct Sandia to establish and implement controls, including a written policy, to ensure that the Payroll Department obtains payroll deduction authorizations before deducting union dues from an employee's pay.

COMMENTS**Management Reaction:**

Management agreed with our findings and its comments were responsive to our recommendations. Management stated that for a period of time, the Payroll department business process has been to utilize system reporting information to start or stop union dues deductions with the belief that the subsequent signed deduction cards were being appropriately obtained. Management stated that Payroll personnel have met with the union noted in the finding and documented the business process for starting deductions based on signed dues deduction cards as well as other related processing areas (dues discontinuation, retroactive amounts and refunds) including the appropriate responsible parties. It further stated that this is a business process that is internal to the Payroll department and union relationship and is not appropriate to include in a Sandia policy. It then concluded that the documented business process will be utilized for processing of all three union deductions going forward.

Finding 32: Military Leave of Absence (07-NSH-HR-03)

Our review of the Military Leave of Absence (MLOA) charged for two Sandia employees disclosed that Sandia paid two employees in excess of Sandia's policy limit of 88 hours. MLOA pay for the two employees during FY 2007 was 176 and 264 hours, respectively. Both employees were allowed 176 hours during the fiscal year under one set of military orders. The second employee was allowed an additional 88 hours because the employee received orders for another tour of duty after a short period at home.

Although not reflected in Sandia's written policy, Sandia's interpretation of military leave requirements permits eligible employees under military orders to remain on Sandia's payroll and allows them to charge:

- 11 days (88 hours) of military training or active duty leave each fiscal year;
- 11 additional days (88 hours) for emergency call up each fiscal year;
- Accrued flextime and/or vacation after exhausting 22 days of MLOA; and
- Vacation Donation – up to 500 hours available each tour of duty after using all accrued personal flextime and vacation.

Once an employee has exhausted these leave categories, they are placed on "Official Sandia Military Leave of Absence" and Sandia provides a pay differential for 180 days if on continued military duty. The differential is the difference between the employee's Department of Defense earnings and the employee's Sandia salary.

NNSA Service Center personnel stated that they agree with Sandia's interpretation and pointed out that they are not aware of any Department Order or guidance on reimbursing contractors for employee military leave.

Employees were allowed to charge more hours for military leave than permitted by Sandia policy because Sandia's policy is vague and Sandia does not have adequate

COMMENTS

controls to prevent personnel from bypassing policy requirements. When we spoke to Sandia's Benefits Department regarding its policy, the same person provided two different responses. Initially, Sandia stated that the maximum military leave allowed for training and emergency call-up is a total of 22 days (176 hours) each fiscal year. However, in our next conversation, Sandia explained that an employee was allowed to charge a total of 264 hours because he received a new set of military orders in the same fiscal year.

Sandia allowed two employees to charge a total of 264 hours of military leave above that allowed by Sandia policy. The applicable costs for these hours may be unallowable.

Recommendation:

32. We recommended that NNSA's Field CFO, in conjunction with the Manager, Sandia Site Office:
 - a. Direct the Sandia Site Office to review Sandia's military leave policy to determine whether it meets Department requirements, and
 - b. Ensure that Sandia apply the policy consistently to all eligible employees.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Management stated that Sandia's current contract with the NNSA does not contain a specific clause concerning allowances for Military Leave of Absences but does indicate that NNSA will rely on Sandia policies concerning reimbursement to Sandia for employees paid while on military leave. Sandia's time charging policy, Corporate Process Requirement (No. 300.6.15) does not reflect the additional 88 hours of emergency call-up in a fiscal year for each emergency event. Management believes that it is important to note that prior to the October 1, 1993 management and operating prime contract, the additional 88 hours for emergency call-up was included in Appendix A.

Sandia is in the process of completing the following actions:

- 1) Sandia will be modifying its Corporate Process Requirement (CPR) to adequately reflect the additional 88 hours per emergency call-up event in each fiscal year. Target date for completion is November 30, 2007.
- 2) Sandia will examine the U.S.C. 6323, Military Leave, Reserves and National Guardsman along with Sandia's existing policy regarding Military Leave benefits to determine the best path forward for Sandia. Target date for completion is April 1, 2008.

COMMENTS

Accruals

Finding 33: Project Accruals (07-NST-PRO-02)

Our review of a listing of manually-accrued purchase order amounts at KCP as of June 30, 2007, disclosed that the Accounts Payable Department had recorded an accrual for the same purchase order for \$89,000 twice.

The KCP Accounts Payable Department had not established adequate control procedures to prevent or detect the duplicate accrual of a purchase order submitted for manual entry into the accounting records. Both the project manager and the buyer submitted an accrual estimate for the same purchase order in June 2007.

KCP overstated its accrued expenses by \$89,000 as of June 30, 2007.

Recommendation:

33. We recommended that the NNSA's Field CFO, and the Manager, Kansas City Site Office, direct Honeywell, FM&T to establish controls over the manual accrual process for purchase orders to prevent the recording of duplicates.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Management stated that Honeywell FM&T has incorporated changes to ensure the correct accrual amount is properly recorded in the future. It also stated that Honeywell FM&T has a process in place to monitor and identify duplicate manual accruals but this was an oversight since it was a last minute addition and that the staff will be re-educated on this procedure. The process that checks for duplicates will run after last minute adjustments have occurred.

Finding 34: Financial Assistance Award True-up Process (07-FT9-GL-01)

Our test of 23 grant and cooperative agreement accruals at NETL disclosed that 3 accrual balances for contract identification numbers (CID) were fully costed (expensed) as of September 30, 2007. However, these CIDs were above the Department's \$750,000 threshold, for fully costing. Two of the three CIDs were incorrectly fully costed and considered an error. The other identified CID was a transfer from a regional office that was closed.

NETL explained that they had consolidated the financial activities for six regional offices that had closed and transferred their contracts and purchase orders to either NETL or its Golden Field Office. NETL research showed that prior to the automated accrual process, regional offices put in a "permanent accrual." NETL expanded its review to all awards greater than \$750,000 potentially affected by the error and found seven additional CIDs that were either fully costed incorrectly or had a "permanent accrual" in place.

COMMENTS

In conducting the FY 2007 true-up process, NETL did not review 100 percent of the awards above \$750,000. In error, NETL fully costed four awards that were above the Department's threshold of \$750,000. Additionally, NETL found that six permanent accruals that had not been detected had been put into the system by the regional offices prior to the automated accrual process.

As a result of the errors described above, NETL overstated accounts payable for 10 CIDs in the amount of approximately \$13.5 million (3 percent of NETL's accounts payable balance) as of September 30, 2007. NETL notified the Department's Director, Office of Finance and Oversight about the approximate \$13.5 million accrual overstatement and requested that it be posted to the FY 2007 financial statements. The Director indicated that this adjustment would not be posted to the FY 2007 financial statements, but instead would be treated as a waived FY 2007 audit adjustment, or an unadjusted audit difference.

Recommendation:

34. We recommended that the Director, NETL, require that its CFO add a procedure to verify that financial assistance awards with accruals greater than \$750,000 are reviewed to ensure that all current year actions have been correctly costed per documentation to their policies.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. NETL stated that it has updated its Financial Assistance Award True-up procedures to ensure that financial assistance awards with accruals greater than \$750,000 are reviewed to ensure that all current year actions have been correctly costed. NETL performed this procedure for FY 2007 and will continue to perform this procedure annually in future years.

Finding 35: Inconsistent Application of Grant Costing Policy (07-XN9-GL-01)

Our review of the procedures surrounding the grant accrual process at NETL and the Chicago Operations Office (Chicago) disclosed inconsistencies regarding the application of the Department's policy of fully costing grants under \$750,000. NETL fully costs grants with a total original award value of less than \$750,000 at the time of obligation; grants with original award amounts exceeding \$750,000 are subject to monthly accruals and the year-end "true-up" process. Chicago fully costs all grant obligations that are less than \$750,000, even though the total original grant award may exceed \$750,000.

To illustrate this difference, a Chicago grant with an original award amount of \$900,000 that covers three years would be fully costed at \$300,000 each year, if only \$300,000 is obligated each year. However, a NETL grant with an original award amount of \$900,000

COMMENTS

would be subject to monthly expense accruals and the year-end "true-up" process for each of the three years of the grant period.

The inconsistent application relates to the interpretation applied to the "total award" or "award value" cited in the Department's *Accounting Handbook* and the March 2006 *Supplemental Guidance on Costs and Accruals*, respectively.

NETL interprets "total award" and "award value" as the total government share for the entire grant period; whereas, Chicago's interpretation of the terms is the amount obligated in any fiscal year.

Because there is significant difference between the number of grants fully costed under each interpretation, either NETL is understating and or Chicago is overstating the cost and accruals for grant awards which affects amounts in the Department's consolidated financial statements.

Recommendation:

35. We recommended that the Office of Financial Policy take action to clarify the costing ceiling with respect to the "total award" and "award value" for grants by the Department and to ensure the policy is consistently applied.

Management Reaction:

The Office of Financial Policy concurs with the recommendation. Office of Financial Policy will conduct a review of current financial assistance awards cost accrual accounting policies, as well as formulate and issue clarifying guidance to address inconsistent cost accrual accounting practices across the complex pertaining to financial assistance awards.

Finding 36: Accrued Expenses (07-NS9-PRO-01)

Our tests of 15 NNSA Purchase Orders (PO) with accrued expense balances as of June 30, 2007, disclosed 12 POs with errors in the accrued expense amount. These errors resulted in a net over-accrual of \$20.3 million at June 30, 2007.

Our year-end tests of 26 NNSA POs with accrued expense balances disclosed 17 POs with errors in the accrued expense amount. These errors resulted in a net over-accrual of \$14.9 million at September 30, 2007.

The majority of these errors relate to actions by approving officials who did not understand how their posted adjustments in the Vendor Invoice Approving System affected the ending accrued expense balance in STARS.

NNSA overstated accrued expenses by \$20.3 million as of June 30, 2007, and by \$14.9 million as of September 30, 2007.

COMMENTS

Recommendation:

36. We recommended that the NNSA Field CFO review NNSA's internal procedures and ensure, through additional training for approving officials, officials properly identify and record accruals at the end of each accounting period.

Management Reaction:

NNSA's Field CFO organization will take the necessary steps to review NNSA's internal procedures and will provide responsible officials with additional training on how and when to properly record accruals.

Accounts Payable

Finding 37: Incorrect Journal Entries (07-SR9-PRO-01)

A test of 105 POs with accounts payable balances as of June 30, 2007 disclosed that one balance in the amount of \$80 did not represent a valid liability.

Accounting personnel used a custom report in STARS to review POs that required adjustments as of September 2006. This report indicated that one of the POs required an adjustment related to an abnormal balance in Accounts Payable (SGL account 2110). A journal entry was posted to correct the error indicated by the report, leaving a credit balance in the 2110 account. When performing our test work as of June 30, 2007, the site was unable to provide support for the balance in accounts payable. Management researched this item and determined that the information in the custom report used at September 2006 was inaccurate. When the site re-ran the report as of September 2006, it indicated that there was not an abnormal balance for the PO, so no adjusting entry was necessary.

Management indicated that the incorrect entry was due to a problem with the original report, probably caused by human error in entering the report parameters.

The Department overstated the accounts payable SGL account 2110 by \$80 as of June 30, 2007.

Recommendation:

37. We recommended that the Department's CFO, in conjunction with the Manager, Savannah River Operations Office, emphasize to accounting personnel the importance of verifying the accuracy of custom reports in STARS and periodically reviewing accounts payable balances to identify invalid payables.

COMMENTS**Management Reaction:**

Management did not agree with our finding, and provided the following comments: "It appears, based on the audit work, adequate controls are in place. You reviewed 105 purchase orders and found 1 immaterial item (\$80) that did not represent a valid liability. This item has been corrected. Based on the controls in place, we believe any significant item will be detected. Human error will always be in play. We now have a standard abnormal balance report available for use by all field offices. Accordingly, we consider this item closed and no further action necessary."

Auditor Comment:

We acknowledge that the amount is immaterial, but the sample was part of a randomly selected statistical sample from the entire Department's accounts payable population as of June 30, 2007. A projection of the error to the total population would indicate that additional errors existed in the remaining population.

Finding 38: Incorrect Journal Entries (07-CH9-PRO-01)

A test of 105 contracts with accounts payable balances as of June 30, 2007, disclosed that Chicago understated the balance for one contract by \$624,787. Chicago had recently transferred the contract to the Savannah River Office. In preparation for the transfer, Chicago worked with EFASC/Germantown (EFASC/GTN) and the Oak Ridge Financial Services Center (ORFSC) to post entries to clear out all the accounts related to this contract under the Chicago allottee. Chicago did not know, however, that ORFSC had placed an invoice related to this contract "on hold." Chicago posted a clearing entry to bring all accounts to zero. This action created a debit balance in the accounts payable account (2110) and an offsetting credit in the accrued costs account (2190) after ORFSC processed the "on hold" invoice.

Management indicated that the timing of events led to Chicago not detecting the "on hold" invoice when reconciling general ledger balances.

The Department understated the accounts payable SGL account 2110 and overstated the accrued expenses SGL account 2190 by \$624,787 at June 30, 2007. However, there is no overall effect on the consolidated financial statements because these two accounts are reported on the same line in the consolidated financial statements. .

Recommendations:

38. We recommended that the Manager, Chicago, direct its CFO to strengthen procedures that affect contract transfers to include:
 - a. Communication between the field site, EFASC/GTN, and ORFSC to ensure that Chicago is aware of all pending transactions that will affect ending general ledger balances, and

COMMENTS

- b. Follow-up review of contract general ledger balances to ensure that all accounts are properly cleared after transfer.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Management stated that they have revised their policy to ensure that EFASC/GTN and ORFSC are included when they are developing their Plan of Action and Milestones (POAM) for contract transfers. In addition, management stated that their POAM will include follow-up reviews of general ledger balances in STARS to ensure that all accounts are properly cleared after the contract has been transferred.

Finding 39: Invalid Accounts Payable Balances (07-XN9-PRO-01)

A test of 105 POs with accounts payable balances as of June 30, 2007, disclosed that two balances totaling \$1,422,060 did not represent valid accounts payable liabilities, as follows:

One PO with a credit balance of \$1,320,007 represented two offsetting errors:

- A debit balance of \$7,488 represented four payment refunds. When payment refunds are processed, the funds are collected and recorded in the accounts receivable module. In addition, the payment and invoice logging entries are then reversed in the accounts payable module to account for the refund. These balances remain due to an error in processing the reversing entries in which the EFASC only recorded one part of the required entries. EFASC personnel entered the reversing entry for the invoice but did not reverse the entry for the payment. This left a debit balance remaining in the accounts payable account.
- A credit balance of \$1,327,495 represented an invoice that was logged and approved, but was never fully processed. The PO related to these invoices was excluded from the automated costing process. Therefore, no cost entry was made. The balance in SGL account 2110 related to the EMCBC allotment. EMCBC often uses zero pay entries to adjust payments or costs between funding lines. EMCBC sends requests for zero pay entries to EFASC, where they then post the entries. In this instance, EMCBC submitted inaccurate information to EFASC which made them unable to process the entries necessary to clear this balance. This logged invoice was never cancelled in the system, leaving a credit balance in the SGL account 2110.

One PO with a credit balance of \$102,053 represented two invoices that were accidentally entered twice. The invoices making up this balance were never paid because the accounting records showed the Department had paid the invoices. These duplicate invoices were not cancelled from the system, leaving an outstanding balance in accounts payable.

COMMENTS

Department management indicated that the incorrect journal entries posted to the accounting system are the result of human error and poor coordination at EFASC and the EMCBC.

The Department overstated the accounts payable SGL account 2110 by \$1,422,060, partially offset by an understatement of \$1,320,007, in the accrued expenses SGL account 2190. The offsetting amounts did not affect the consolidated financial statements because the two accounts roll up to the same line item. The net effect of the errors is an overstatement of \$102,053 in accounts payable and in program costs (SGL account 6100).

Recommendation:

39. We recommended that the EFASC Director emphasize to all DOE accounting personnel the importance of accurately recording all required parts of accounting entries and cancelling transactions in the system when necessary.

Management Reaction:

The EFASC will continue to train and remind employees regarding the importance of ensuring that transactions are properly and accurately processed in the accounting system with emphasis on data integrity and controls.

Finding 40: Recording Lease Liabilities (07-OR9-PRO-01)

A test of 105 purchase orders with accounts payable balances as of June 30, 2007, disclosed that one item amounting to \$122,934 did not represent a valid liability. The item related to lease payments due on the first of August, September, and October 2007, and the Department had not incurred the costs as of June 30, 2007. ORFSC paid the payment due July 1, 2007 by June 30, 2007, so that payment, was not included in accounts payable.

ORFSC had recorded an expense and a corresponding liability for the 12-month lease period because it would not receive monthly invoices under the lease agreement. ORFSC chose this method so it would not forget to make the monthly lease payments, thinking that the action was similar to ORFSC's normal procedure for recording a liability when receiving an invoice for payment.

ORFSC overstated expenses and the liability in the accounts payable account by \$122,934 as of June 30, 2007.

COMMENTS

Recommendation:

40. We recommended that the Manager, Oak Ridge Office, direct the CFO, Oak Ridge Office to take action to ensure that costs and liabilities associated with leases are recorded as they become a payable liability over the life of the lease.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. The procedures and processes for recording and monitoring costs and liabilities, including those for lease payments, will be discussed with the appropriate ORFSC staff members.

Finding 41: Separation of Duties (07-NST-PRO-01)

According to the check printing procedures at the Kansas City Plant, an employee in the accounts payable department must approve payments before the checks can be printed by the finance department. During a walkthrough of the check printing process, we noted that the three individuals in the finance department authorized to print checks were also authorized to approve payments.

We noted two mitigating controls that occur in this process: 1) when finance personnel approve the checks for printing, an email notification is sent to the employee in accounts payable informing her that the checks had been approved; and 2) finance personnel are not able to create vouchers, another step needed to create fraudulent checks. However, these are considered passive or reactive controls, not preventive controls.

The authority to approve payments and print checks are both included under the same access role in the check payment software system. Therefore, when the finance personnel were assigned this access role for check printing capabilities, they were also given the ability to approve payments.

The risk for fraudulent transactions increases when duties are not segregated between the payment approval and the check printing process.

Recommendation:

41. We recommended that the NNSA's CFO, in conjunction with the Manager, Kansas City Site Office, direct Honeywell FM&T to strengthen controls in the finance payment system by separating duties between payment approval and the check printing process. Potential controls include creating a new role for the check printing capability by finance personnel and deleting the present dual authority in the check payment software system.

COMMENTS

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Honeywell FM&T stated it has incorporated changes to the software which is used to print and approve checks. A new access role in the software system was created, tested, and implemented after this issue was discovered. Segregation of duties for preventative controls was accomplished through a new role which is granted exclusively to Accounts Payable department employees for approval of payments. Employees who print checks can no longer perform this function.

Intragovernmental Transactions

Finding 42: Incorrect Trading Partner Code (07-XN9-INTG-01) (Revised)

Our test of 150 disbursements by the Department between October 1, 2006, and August 31, 2007, disclosed one error in which STARS assigned a Federal trading partner code to a non-Federal vendor.

Management indicated that the incorrect trading partner code was the result of an incorrect trading partner code on the supplier record in STARS.

The incorrect trading partner code caused the Department to report the non-Federal vendor transaction to the U.S. Department of the Treasury (Treasury) as an intragovernmental transaction. The Department corrected the supplier record error before year-end, so that the vendor's transaction will be reported correctly to Treasury.

Recommendation:

42. We recommended that the Director, Office of Finance and Oversight, strengthen controls over the accuracy of trading partner data by conducting periodic reviews of the trading partner codes assigned to supplier records.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. The Office of Finance and Oversight staff will conduct periodic reviews of trading partner codes assigned to supplier records.

Undelivered Orders

Finding 43: Costing of Grant Awards (07-CH9-GL-01)

A test of 30 grants with current year obligations at Chicago disclosed the following three instances where grants with award values of \$750,000 or less were not simultaneously obligated and costed:

COMMENTS

- *CID ER25804* – A current year award of \$127,489 was obligated in STARS on January 31, 2007. The corresponding cost entry was not recorded in STARS until February 2007.
- *CID ER41294* – A current year award of \$195,000 was obligated in STARS on March 21, 2007. As of March 31, 2007, no corresponding cost entry had been posted. As of June 30, 2007, STARS showed costs of \$22,633 with no payments recorded against the current year obligation.
- *CID ER15588* – A current year award of \$273,519 was obligated on January 31, 2007. No corresponding cost entry was recorded at the time. As of June 30th, STARS showed costs of \$160,543 and payments of \$133,478 against the current year obligation.

A test of 19 undelivered orders at Chicago disclosed one instance in which a current year grant with an award value of \$750,000 or less was not simultaneously obligated and costed:

- *CID ER45429* – A current year award of \$329,911 was obligated in STARS in December 2006. As of June 30, 2007, STARS showed costs of \$244,413 and payments of \$105,740 against the current year obligation.

An accountant at Chicago prepares a spreadsheet that contains the listing of cost entries for actions less than \$750,000. This list is then sent to the EFASC. EFASC posts the costing entries to STARS and then informs the accountant when the entries are complete.

In the case of *CID ER25804*, the award was obligated January 31, 2007, but the cost entry was not sent to EFASC until February 6, 2007.

CIDs *ER41294*, *ER15588* and *ER45429* were not properly identified as awards of \$750,000 or less. Thus, no cost entry was prepared.

The effect of not costing awards of \$750,000 or less at the time of obligation is an understatement of costs and an overstatement of uncosted obligations. The effect on the four current year awards follows:

- *CID ER25804* – There is no net effect as of June 30, 2007, as the award was fully costed in February.
- *CID ER41294* – The award was under accrued by \$172,367 at June 30, 2007, under the Department's cost accrual guidelines. Payments did not exceed costs.
- *CID ER15588* – The award was under accrued by \$112,976 at June 30, 2007, under the Department's cost accrual guidelines. Payments did not exceed costs.
- *CID ER45429* – The award was under accrued by \$85,498 at June 30, 2007, under the Department's cost accrual guidelines. Payments did not exceed costs.

COMMENTS

Recommendations:

43. We recommended that the Manager, Chicago, direct its CFO to establish procedures that include:
 - a. Submitting the corresponding cost entries to EFASC by the end of the month in which the obligations were made;
 - b. Verifying that cost entries have been made by EFASC, and
 - c. Periodically verify that all current year actions of \$750,000 or less have been costed.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations. Management stated they have already implemented revised costing policies and practices. These corrective actions are:

1. CH will ensure that cost entries are submitted to EFASC by the end of the month in which the obligation was made. Procurement officials will submit all documents by noon on the day before the last workday to be included in current period activity.
2. CH will verify that cost entries have been made by EFASC. We have instructed CR staff to review STARS reports to ensure that requested transactions have been accurately recorded. Supporting documentation is now being maintained subject to audit.
3. CH will periodically verify that all current year actions of \$750,000 or less have been fully costed. CR has implemented a review and reconciliation process that compares monthly PADS obligations of \$750,000 or less to corresponding cost amounts in STARS. Any differences will be corrected before month-end close.

Management believes that these corrective actions will preclude future recurrences and that these three recommendations may be closed with the audit report.

Finding 44: Misstatement of June 30, 2007 Cumulative Obligations (07-RL9-BUD-01)

Richland found that the undelivered orders (UDO) balance for CID RL13200 in STARS was overstated by \$2,826,113 as of June 30, 2007, when compared to the total of contract source documents. Richland's research showed it had (1) added to the account appropriations of \$2,236,859 that should have been added to a blank CID; (2) not returned to Headquarters, \$431,369 in funding for five completed line item projects; (3) not added \$5,629 for a recast of funding; and, (4) not identified the cause of the

COMMENTS

remaining difference of \$163,514. Richland initiated corrective actions for items 1, 2, and 3 in July and August 2007.

Richland officials identified the differences for items 1 and 2 during their initial review work of UDOs with abnormal balances as early as May 2007. However, Richland had not established formal procedures to ensure timely initiation and follow-up of corrective actions once they identified errors in the accounting system.

While Richland overstated the UDO balance by \$2,826,113 as of June 30, 2007, subsequent corrections reduced the overstatement to \$163,514, for CID RL13200. This overstatement remained uncorrected as of September 30, 2007.

Recommendation:

44. We recommended that the Manager, Richland, require its CFO to establish formal procedures to ensure timely correction of identified errors in the budgetary accounts in STARS.

Management Reaction:

Management provided the following comments relating to this finding and recommendation: "We disagree in part with the condition as stated. Condition (1) states 'incorrectly added appropriations of \$2,236,859 to the account.' As discussed with the auditor, the correcting entry made in the STARS system incorrectly identified UDO RL13200 in the descriptive flex field instead of leaving it blank. The statement as written would lead the reader to assume the appropriation was overstated. Condition (2) refers to funds of \$431,369 'not returned to Treasury,' the statement should be reworded to say 'not returned to DOE-HQ.'"

"We concur with the recommendation. In response to the weakness identified in this audit, Richland has already developed and implemented a procedure that incorporates contract reconciliation for each funding modification and the STARS system for all cumulative obligation contract balances. In addition, Richland has specifically identified responsible individuals for each Richland contract. This will help ensure that corrections are coordinated internally and entries are accurate, timely and complete."

Auditor Comment:

Based on management's response, we have revised the condition to reflect more accurately the events and issues.

Finding 45: Backlog of Inter-entity Cost Transfers (07-XN9-BUD-01)

At September 30, 2007, the Department had about \$84 million of unprocessed inter-entity (IE) bills, which could potentially affect the accuracy of the financial statements' undelivered orders balance. DOE field sites and integrated contractors (authorizing

COMMENTS

entity) use other DOE entities (performing entity) to perform services through inter-entity work arrangements. To prevent a duplication of fund obligations between the authorizing entity and the performing entity within the DOE accounting system, the performing entity is required to record obligations and expenses in Fund 00911. The Department subsequently reduces the authorizing entity's obligations, referred to as undelivered orders in its financial statements, by billings from the performing entity processed through Fund 00911.

The EFASC has been researching system options that could more efficiently identify the unbilled costs and gave the following as factors contributing to the backlog:

- Available STARS reports to account for unprocessed IE bills are inadequate. The reports do not identify what payment invoices have or have not been billed, do not identify the date the payment invoices were created, do not specifically and accurately identify the authorizing office or contractor that needs to be billed, and do not identify costs from conversion to the present accounting system that need to be billed.
- Variation in how the IE process was performed in the legacy system and then converted to STARS still requires extensive research in order to identify what costs should be billed.
- Shortage of staff prevents EFASC from applying adequate resources to work on the backlog. The current process to identify the related authorizing offices for fund 00911 unbilled costs requires EFASC to perform a labor-intensive review and analysis.
- Accounting process complexity combined with the volume of IE transactions.

Because of the backlog, there is a lack of timely application of payments to the appropriate project funding sources resulting in potentially overstated unpaid obligation balances in the authorizing entities' accounting records. The inability of EFASC to determine the aging of the IE cost transfers in the backlog limits their determining whether the costs are only current amounts. If the backlog contains legacy system amounts not offset by obligations at the authorizing entities, the debit balance amount in fund 00911 at the performing entities would understate the undelivered orders balance in the consolidated financial statements.

Recommendation:

45. We recommended that the Director, EFASC, continue to investigate and implement system options to improve the tracking and efficiency of the IE work billing process and to work with the Office of Corporate Information Systems' STARS Project to develop adequate STARS reports that will facilitate the accounting process.

COMMENTS

Management Reaction:

Management agreed with our finding and its comments were responsive to our recommendation. The EFASC will continue to investigate and implement improvements to the IE work billing process.

Work-for-Others

Work-for-Others (WFO) is work performed for non-Department entities that utilize the Department's personnel, facilities, or contract personnel and is not directly funded, in whole or in part, by the Department. Contractors can perform WFO when approved by the Department and are required to follow Federal requirements for reimbursable work.

Finding 46: Work-for-Others (07-NSH-REV-01)

A test of 30 WFO transactions disclosed that Sandia began work or incurred costs on four WFO agreements before the official signing of a reimbursable agreement by a DOE/NNSA officer.

Agreement MD7030268P0411 – A Sandia manager processed an amended time card charging an employee's time for work of \$2,984 before NNSA authorized the agreement.

Agreement 07W133 – A data input error in the expiration date field caused Sandia to incur costs on the wrong agreement before NNSA authorization and before the correct agreement was fully costed.

Agreement H448018 – The WFO sponsor instructed Sandia's Project Manager to begin charging costs to this agreement once Sandia received the funding from the sponsor because the sponsor needed to show immediate activity on the funds. As a result, Sandia incurred costs for work before receiving NNSA authorization.

Agreement MIPR7AFJ5B1612 – After NNSA properly authorized this agreement in October 2006, a Sandia Project Manager transferred costs to this project which were incurred in September 2006, prior to the authorized start date. After realizing that costs were incurred prior to authorization, the Project Manager reversed the cost transfer.

In each case, Sandia lacked controls to prevent these actions or monitor WFO costs to identify when WFO agreements were charged costs before receiving NNSA approval. In addition, the responsibility for certain functions was not always clear. For example, Sandia's WFO Office believes that financial analysts on each project (line personnel) should be monitoring charges/billings on applicable projects/agreements to prevent input type errors. Line personnel agreed that the line is responsible for monitoring costs, but not at the level described by the WFO office. Sandia's Financial Manual, however, states that it is the Project Manager's responsibility to ensure that no costs are incurred prior to the agreement being signed and that costs are appropriately charged to the correct project.

COMMENTS

Sandia did not comply with Department requirements by charging cost to projects prior to receiving NNSA authorization. In addition, Sandia exceeded the funded cost limit on one WFO agreement by \$18,865.

Recommendation:

46. We recommended that NNSA's Field CFO in conjunction with the Manager, Sandia Site Office, direct Sandia to establish or enhance controls and clarify roles and responsibilities to ensure that costs are not incurred on reimbursable work until NNSA accepts the reimbursable work agreement.

Management Reaction:

Management agreed with our finding and its comments were responsive to our recommendation, and provided the following comments: "Center Business Managers will conduct a self-assessment and review a percentage of corrected timecards in their Center involving WFO projects. The self assessment will be tracked in the corporate Laboratory Enterprise Self Assessment database. A self assessment program will be established by the Work for Others Financial Management Department. This will ensure that the period of performance is being monitored."

"Training will also be conducted to educate line organization staff on the calculation of the sequencing of agreements tied to a single WFO project."

Finding 47: Work-for-Others (07-NSH-REV-02)

A test of 30 WFO transactions disclosed that Sandia waived a Federal Administrative Charge (FAC) of 3 percent on one agreement without a valid waiver. The original proposal was approved by NNSA on March 3, 2006 with no FAC waiver. However, on September 19, 2006, a Sandia manager used this WFO agreement to test inputting a FAC exception scenario without realizing that the Electronic Work-For-Others (eWFO) database recorded the action. The manager thought the eWFO system would not accept the change unless the "Save" button was pressed. The manager, having system administrator privileges, subsequently learned that the changes were automatically accepted without pressing the "Save" button.

Based on the modification above, the NNSA processed and approved the subject Interdepartmental Purchase Request on January 8, 2007, including the FAC waiver.

After the Office of Inspector General (OIG) brought this condition to the attention of Sandia's WFO Office, Sandia submitted a correction to the NNSA for recertification with funds being moved from Sandia's portion to FAC. Sandia completed this action and made corrections to the system on August 14, 2007 and has since run a query on the eWFO system to verify that no other changes of this sort have occurred.

COMMENTS

Sandia had not established procedural controls for independently verifying the accuracy of changes made to reimbursable agreements in the eWFO database.

Additionally, the NNSA review of the subject agreement did not identify that FAC should not have been waived and incorrectly approved the agreement.

By incorrectly waiving DOE's FAC on this agreement, Sandia was allowed to keep \$4,369 that should have been remitted to DOE.

Recommendations:

47. We recommended that NNSA's Field CFO, in conjunction with the Manager, Sandia Site Office:
 - a. Direct Sandia to establish or enhance controls to ensure that changes to WFO agreements in the eWFO system are independently reviewed and approved, and
 - b. Evaluate NNSA's process for reviewing and approving WFO agreements at Sandia and other Management & Operating contractors under their purview, and take the actions necessary to strengthen this process so that similar errors do not occur in the future.

Management Reaction:

Management agreed with our findings and its comments were responsive to our recommendations, and provided the following comments: "Upon further review, it has come to light that the FAC waiver is reviewed when the original proposal is being processed for approval. Once the proposal is approved, the eWFO system 'locks' in the waiver information. The waiver can then only be modified by an individual with eWFO administrator privilege. Although this is an isolated incidence, organization 09732 will implement a report to generate a notification to the eWFO manager when a finalized NNSA approved FAC waiver has been changed. This will insure that management reviews FAC waiver changes made to the eWFO system.

Training will also be conducted for future system administrators. The FAC amount to DOE is now current and being remitted to DOE as required."

Managerial Cost Allocation

Finding 48: Incomplete Written Procedures (07-XN9-FR-01)

The Department does not have complete and up-to-date formal written procedures for the Managerial Cost Allocation process. While some procedures are documented in the *DOE Mass Allocation – Program Goal Allocation User's Guide* (Guide), all phases, such as the establishment of (B&R) codes and the preparation of the crosswalk spreadsheet are not included in the Guide. Without fully documented procedures for employees to follow, it

COMMENTS

is not clear whether each of the different phases of the cost allocation process is properly performed.

Through discussions with key personnel and a review of the Guide, we obtained an understanding of the Department's allocation process and determined that program direction and overhead costs were properly allocated and direct costs were appropriately classified in the statement of net costs.

The Department recently implemented the STARS automated Managerial Cost Allocations routine and did not have sufficient time or resources to complete its update of the Guide and to test all procedures used in the allocation process.

A lack of complete and up-to-date documented procedures can result in inaccurate reporting of information and weak management controls over changes made in the process. Also, a lack of a sufficiently defined process can cause inconsistencies in procedures performed by assigned personnel and a lack of consistency should personnel change from year to year.

Recommendation:

48. We recommended that the Office of CFO update the *DOE Mass Allocation – Program Goal Allocation User's Guide* to include up-to-date responsibilities, accountability, and complete documentation required of the personnel involved in all phases of the Managerial Cost Allocation process.

Management Reaction:

Management agreed with our findings and stated that the *DOE Mass Allocation – Program Goal Allocation User's Guide* will be updated in FY 2008.

Required Supplementary Stewardship Information

Finding 49: Improved Controls over Required Supplementary Stewardship Information Reporting (07-XN9-FR-02)

On November 9, 2007, seven days after the final draft AFR was due to us, the Office of the CFO (OCFO) identified significant variances between Required Supplementary Stewardship Information (RSSI) amounts reported in FY 2007 and prior years as it performed a variance analysis required for the closing package. Review by the OCFO and the Office of Science revealed that one Budget and Reporting (B&R) or Standard Accounting and Reporting System (STARS) code had been excluded from the listing used by the OCFO to generate the costs, while only a portion of the activity in another code in the listing was included in the RSSI reported in FY 2006. The proper inclusion of these codes and related costs resulted in a change of \$991.5 million to the FY 2006 costs reported under the Scientific Breakthroughs & Foundations of Science category. A similar situation affecting two line items occurred under the NNSA Nuclear Deterrent category. The inclusion of the previously omitted NNSA B&R/STARS codes resulted in

COMMENTS

an untimely submission of R&D costs for FY 2007 and increases of \$433.4 million and \$584.4 million, respectively, for Nuclear Deterrent Applied and Development costs reported for FY 2006. The Department did not have a timely process for ensuring the completeness and accuracy of RSSI reported in the AFR. The potential exists for costs reported in the Department's RSSI to be incomplete or inaccurate.

Recommendation:

49. We recommend that the OCFO improve the timeliness of its procedures so that it can ensure that the costs reported in the RSSI are complete and accurate before they are submitted with the final AFR.

Management Reaction:

Management agrees with the recommendation. The Office of Internal Review has already begun taking a number of actions to ensure that reported costs are accurate and updated in a timely manner. Corrective actions will include: 1) Documenting the process for developing and reporting RSSI R&D costs to an A-123 standard to ensure that key risks and controls are identified; 2) increasing the level of automation in the R&D reports to help minimize the potential for human error; 3) holding a pre-reporting meeting/workshop to ensure that program contacts providing STARS codes fully understand the process prior to beginning data collection activities; and 4) performing data and variance analyses on both the third quarter and final draft data to help identify any potential issues earlier in the process.

Action Plan with Milestones

Milestones	Projected Completion
Document Process to A-123 Standard	1/15/08
Re-program R&D reports to increase level of automation	5/30/08
Hold training meeting/workshop for programs to ensure understanding of requirements	6/30/08
Perform initial data and variance analyses to identify any reporting issues prior to issuance of 3 rd quarter draft	8/15/08
Perform final data and variance analyses to identify any reporting issues prior to issuance of final auditors draft	Date TBD based on audit schedule.

STATUS OF PRIOR YEAR FINDINGS**Status at September 30, 2007****Accounting for Obligations and Undelivered Orders**(FY 2006 Reportable Condition
Considered a Material Weakness)

- | | | |
|-----|---|-----------------------------|
| 1. | Monitoring of Uncosted Obligations(Undelivered Orders
(06-CH9-BUD-01)) | Closed in fiscal year 2007. |
| 2. | Timely Recording of Obligations (06-CH9-BUD-02) | Closed in fiscal year 2007. |
| 3. | Costs Exceeding Obligations (06-CH9-BUD-03) | Closed in fiscal year 2007. |
| 4. | Incorrect Undelivered Orders Balances
(06-ID9-BUD-01) | Closed in fiscal year 2007. |
| 5. | Duplicate Payments for Travel Related Expenses
(06-ID9-BUD-02) | Closed in fiscal year 2007. |
| 6. | Timely Recording of Obligations (06-ID9-BUD-03) | Closed in fiscal year 2007. |
| 7. | Overdue De-obligations (06-ID9-BUD-04) | Closed in fiscal year 2007. |
| 8. | Obligations Recorded Untimely (06-FT9-BUD-01) | Closed in fiscal year 2007. |
| 9. | Supporting Documentation for Indirect Cost Uncosted
Obligations (06-FT9-BUD-02) | Closed in fiscal year 2007. |
| 10. | Overdue De-Obligations (06-FT9-BUD-03) | Closed in fiscal year 2007. |
| 11. | Negative Undelivered Orders (06-FT9-BUD-04) | Closed in fiscal year 2007. |
| 12. | Timely Recording of Obligations (06-NS9-BUD-01) | Closed in fiscal year 2007. |
| 13. | Timely Receipt of Contract Modifications
(06-NS9-BUD-03) | Closed in fiscal year 2007. |
| 14. | Costs Exceeding Obligations (06-NS9-BUD-04) | Closed in fiscal year 2007. |
| 15. | Timely Recording of Obligation (06-OR9-BUD-01) | Closed in fiscal year 2007. |
| 16. | Costs Exceed Obligations (06-OR9-BUD-02) | Closed in fiscal year 2007. |
| 17. | Incorrect Undelivered Orders Amounts
(06-WA9-BUD-01) | Closed in fiscal year 2007. |
| 18. | Overdue De-Obligations (03-WA9-BUD-01) | Closed in fiscal year 2007. |
| 19. | Misstated Uncosted Obligations (04-OR9-BUD-01) | Closed in fiscal year 2007. |
| 20. | Overdue De-obligations (04-NS9-BUD-01) | Closed in fiscal year 2007. |

Performance Measurement Reporting(FY 2006 Reportable Condition
not considered a Material Weaknesses)

- | | |
|-----|---|
| 21. | Performance Measure Reporting (06-XN9-PERF-01) |
| 22. | Quarterly Milestone Reporting (06-XN9-PERF-03) |

**See reason for tabling these
findings in section following
reissued findings.**Tabled Finding in FY 2007 –
see Tabled Finding 1.Tabled Finding in FY 2007 –
see Tabled Finding 2.

STATUS OF PRIOR YEAR FINDINGS

<u>Other Comments</u>	<u>Status at September 30, 2007</u>
<i>Environmental Liabilities</i>	
23. Update of Contingent Liability for Repository Delay (06-XN9-EL-01)	Closed in fiscal year 2007.
24. Plutonium Disposition (06-XN9-OEL-01)	Closed in fiscal year 2007.
25. Environmental Liability Cost Estimates (06-WAK/L-EL-01)	Closed in fiscal year 2007.
26. Inaccuracies in the Environmental, Safety and Health Liabilities (06-NS1-EH-01)	Closed in fiscal year 2007.
27. Inaccuracies in the Environmental, Safety and Health Liabilities (06-OR4-EH-01)	Closed in fiscal year 2007.
28. Misstatements of September 30, 2005 Environmental Liabilities (06-RL9-EL-01)	Closed in fiscal year 2007.
29. Accounting For Subsequent Events (06-SR9-EM-01)	Closed in fiscal year 2007.
<i>Environmental Liabilities for Active Facilities</i>	
30. Inaccuracies in the Active Facilities Data Collection System (05-CH6-AF-01, 06-NS1-AF-01, 06-NS3-AF- 01, and 06-ORG-AF-01)	All findings closed in FY 2007. Similar findings are reported in Exhibit A.
31. Effectiveness of Internal Controls (06-NS1-AF-02)	Closed in fiscal year 2007.
<i>Inventory</i>	
32. Depleted Uranium Inventory at BWXT Y-12 (06-ORG-INV-01)	Closed in fiscal year 2007.
33. Physical Inventory Procedures at the Kansas City Plant (06-NST-INV-01)	Closed in fiscal year 2007.
34. Capitalization of Post-Retirement Benefits (06-XN9-INV-01)	Closed in fiscal year 2007.
35. Obsolete Inventory (06-NSH-OI-01)	Closed in fiscal year 2007.
36. Verification of Transfer (06-NSQ-NM-01)	Closed in fiscal year 2007.
<i>Property, Plant and Equipment</i>	
37. Construction-Work-In-Progress (05-NS1-PPE-01)	Closed in fiscal year 2007.
38. Fixed Asset Balance (06-CH2-PPE-01)	Closed in fiscal year 2007.
39. Capitalization of Indirect Costs (06-CH2-PPE-02) (Revised)	Closed in fiscal year 2007.
40. Depreciation Expense (06-NSH-PPE-01)	Closed in fiscal year 2007.
41. Accounting for Capital Leases (06-NSH-PPE-02)	Closed in fiscal year 2007.
42. Depreciation of Property Plant and Equipment (06-NST-PPE-01)	Closed in fiscal year 2007.
43. Capitalization of General and Administrative Expenses (06-NST-PPE-02)	Closed in fiscal year 2007.
44. Construction-Work-In-Process (06-NST-PPE-03)	Closed in fiscal year 2007.
45. Retroactive Depreciation of Improvements or Betterments (06-NST-PPE-04)	Closed in fiscal year 2007.

STATUS OF PRIOR YEAR FINDINGS

<u>Other Comments, Continued</u>	<u>Status at September 30, 2007</u>
46. Data entered incorrectly (06-ORG-PPE-01) 47. Capitalization of Indirect Costs (06-ORG-PPE-02) 48. Timeliness of Capitalization (06-ORG-PPE-03)	Closed in fiscal year 2007. Closed in fiscal year 2007. Closed in fiscal year 2007.
<i>Payments</i>	
49. Prompt Payment Act (06-WA9-PRO-01) 50. Payment Approval of Invoice for Services (06-NSH-PRO-01) 51. Lack of Funds (06-OR9-PRO-01)	Closed in fiscal year 2007. Closed in fiscal year 2007. Closed in fiscal year 2007.
<i>Accruals</i>	
52. Accounts Payable and Accrued Expenses (05-WA9-PRO-01) 53. Automatic Processing of Accrual Expenses (06-XN9-PRO-01) 54. Accounts Payable and Accrued Expenses (06-XN9-PRO-02) 55. Accrued Expenses (06-XN9-PRO-03) 56. Accounts Payable and Accrued Expenses (06-OR9-PRO-02) 57. Receivable Balance Recorded in Accounts Payable Subledger (06-NSH-PRO-01) 58. Grant Accruals (06-XN9-GL-01) 59. Accrued Expenses (06-FT9-GL-01) 60. Unexpended Grants (06-FT9-GL-02)	Closed in fiscal year 2007. Closed in fiscal year 2007. Reissued Finding in FY07 – see repeat finding 1. Closed in fiscal year 2007. Reissued Finding in FY07 – see repeat finding 2. Closed in fiscal year 2007. Closed in fiscal year 2007. Closed in fiscal year 2007. Closed in fiscal year 2007.
<i>Integrated Contractor Trial Balances</i>	
61. Integrated Contractor Trial Balance Reconciliation (06-ORG-FR-01)	Closed in fiscal year 2007.
<i>Reconciliation of Data</i>	
62. Significant Balancing Edit Errors (05-XN9-FR-02)	Closed in fiscal year 2007.
<u>Comments Related to FY2006 Material Weaknesses</u>	<u>Status at September 30, 2006</u>
<i>Financial Management and Reporting – Other</i>	
63. Analysis of Budgetary/Proprietary Relationships (05-XN9-BUD-08) (Revised) 64. Standard General Ledger Errors (05-XN9-CP-01) (Revised)	Closed in fiscal year 2007. Closed in fiscal year 2007.
<i>Undelivered Orders</i>	
65. Overdue De-Obligations (03-WA9-BUD-01) 66. Overstated Uncosted Obligations (04-OR9-BUD-01)	Closed in fiscal year 2007. Closed in fiscal year 2007.

STATUS OF PRIOR YEAR FINDINGS

REISSUED FINDINGS IN FY 2007

Accruals

Repeat Finding 1: Accounts Payable and Accrued Expenses (06-XN9-PRO-02)

The referenced finding remains open.

In FY 2006, we reported that a test of 105 accounts payable balances disclosed that 5 items tested did not represent valid liabilities as of June 30, 2006. Two invalid amounts relate to prepayments, which were not offset when paid because a prepayment transaction code was not programmed correctly in the Department's Standard Accounting and Reporting System (STARS). Three invalid amounts relate to transactions converted to STARS from the Department's prior accounting system, which did not differentiate between accounts payable and accrued expenses. In the conversion to STARS, many of the balances that related to accrued expenses were cross walked incorrectly to the Standard General Ledger (SGL) account 2110, accounts payable. We agreed with management's response that the Oak Ridge Financial Service Center (ORFSC) should correct the errors resulting from the prepayment transaction code. We also agreed that guidance should be issued to field offices in FY 2007 to correct offsetting SGL accounts 2110 and 2190 balances resulting from conversion of accrued expenses.

In FY 2007, our test of 105 purchase orders with accounts payable balances as of June 30, 2007, disclosed that two balances did not represent valid liabilities, and resulted during the conversion to STARS from the Department's prior accounting system (DISCAS). One amount related to incorrect accounting entries in the prior system when accounting personnel used different map codes to clear out the accounts payable balance. This process created a debit balance in account DISCAS account 3141, which converted to SGL Accounts Payable account 2110 in STARS. The other invalid amount related to a credit balance converted to SGL account 2110 that was offset by a converted debit balance converted to SGL account 2190, accrued expenses. Although the individual account balances were not correct, the debit and credit amounts offset each other and had no effect on the Department's consolidated financial statements at June 30, 2007.

Recommendation:

1. We continued to recommend that the Department's Chief Financial Officer take action to ensure that errors resulting from the conversion are identified and corrected at the individual accounts payable and accrued expense levels.

STATUS OF PRIOR YEAR FINDINGS

Management Reaction:

The Department concurs in the recommendation. Actions taken during FY 2007 have substantially reduced the types of errors resulting from conversion. These actions included implementing a new abnormal balance report which field offices are using to research and correct the types of offsetting balances identified in the audit sample. Efforts will continue in FY 2008 to research and correct remaining problems.

Repeat Finding 2: Accounts Payable and Accrued Expenses (06-OR9-PRO-02)

The referenced finding remains open.

In FY 2006, we reported that our test of 105 accounts payable balances disclosed that one balance of \$2,378 did not represent a valid liability as of June 30, 2006. The account balance for this purchase order was related to two checks returned by the vendor to ORFSC and subsequently voided. However, due to human error, ORFSC did not cancel the related invoices and remove all the amounts from the accounting records after determining that the invoices were not subject to payment. Management concurred with this finding and our recommendation that the Oak Ridge Operations Office emphasize to accounts payable personnel the importance of canceling an invoice and removing the amount from the accounting records when the invoice is determined to be no longer valid.

In FY 2007, we tested 105 purchase orders with accounts payable balances as of June 30, 2007. This review disclosed that one item tested, a travel voucher that was posted in STARS in error, did not represent a valid liability. The error resulted from a traveler profile entered into the GovTrip travel system with an incorrect social security number. When this transaction was interfaced into STARS from GovTrip, the payment was put on hold in STARS by ORFSC personnel because the name did not match for that social security number. A subsequent travel authorization with the correct social security number was processed in STARS, but the original invoice remained on hold and had not been cancelled as of our test work date. ORFSC management indicated this was the result of human error.

Recommendation:

2. We continued to recommend that the Manager, Oak Ridge Office, direct the CFO, Oak Ridge Office to emphasize to accounts payable personnel the importance of canceling an invoice and removing the amount from the accounting records when the invoice is determined to no longer be valid.

Management Reaction:

Oak Ridge Office management concurs with the finding and recommendation. The procedures and processes for monitoring and canceling invoices will be discussed with the appropriate ORFSC staff members.

STATUS OF PRIOR YEAR FINDINGS

TABLED FINDINGS ISSUED IN FY 2006

Because the Department participated in a FY 2007 pilot program for producing an AFR rather than a *Performance and Accountability Report* (PAR), no detailed performance measures were included in this year's report and, as such, testing performance measures were not part of our FY 2007 audit scope. The Office of Inspector General plans to test performance measures in conjunction with the Department's issuance of a *Performance Report* in February 2008, and will follow-up on these findings at that time.

Performance Measurement Reporting

(FY 2006 Reportable Condition not considered a Material Weaknesses)

Background - The Department presented performance measures and associated results in the Performance Results and Management's Discussion and Analysis sections of its FY 2006 PAR. The Department has implemented a system to collect performance measurement results quarterly, from the various Headquarters, field, and contractor elements. The Department has also issued guidance to ensure that reported performance results are adequately supported by documentation that can be independently verified. However, the results of our 2006 testing indicated that the Department's performance reporting process does not always ensure that reported performance information reflects actual performance and is adequately supported.

Tabled Finding 1: Performance Measure Reporting (06-XN9-PERF-01)

Our test of 29 targets from the 204 annual performance targets reported for the third quarter of FY 2006 disclosed that documentation did not adequately support the achieved goal reported for six targets. Of these six, four were related to targets reported by the NNSA, one by Nuclear Energy (NE), and one by the Office of Civilian Radioactive Waste Management (OCRWM).

In two of these cases, we determined that the performance results were reported incorrectly as of June 30, 2006 in both Joule and the Department's interim PAR. Our specific findings are as follows:

- NNSA – NNSA scores its targets for the first three quarters of the fiscal year based on whether the target is “on track” to meet its yearly goal, rather than an assessment against an established quarterly goal. Only at fiscal year-end does NNSA score each target's actual yearly performance against an established yearly goal. A green coding in any of the first three quarters indicates that the program is on track to accomplish its yearly target, and green in the fourth quarter indicates that it has completed the target.
 - NNSA target NA GG 2.46.04, “Second Line of Defense Sites with Nuclear Detection Equipment Installed,” was assessed as green for the 3rd quarter in Joule. We were not provided with sufficient supporting documentation for two of the four “in progress” components of this target. However, we received a project

STATUS OF PRIOR YEAR FINDINGS

schedule dated June 16, 2006 (before the end of the 3rd quarter) that listed the System Level Acceptance Testing completion date as November 25, 2006 for one of the four “in progress” components of this target. Each of the four target components was required to be completed before the end of the fiscal year for this target to be achieved. Therefore, performance results for this target were incorrectly reported as green as of June 30, 2006.

- NNSA targets NA GG 1.29.05 “Nuclear Survivability Tools Developed,” and NA GG 1.29.03 “Lifetime Assessments, Predictive Aging Models, and Surveillance Diagnostics Delivered,” were assessed as “green” for the 3rd quarter in Joule. Both of these targets were multi-year targets attempting to achieve a specific FY 2006 percentage increase towards a cumulative percentage of completion at fiscal year end (NA GG 1.29.05 - 3% FY 2006 increase, 27% of project completed at the end FY 2006; NA GG 1.29.03 – 8% annual increase and 32% cumulative). One of our initial documentation requests was for a schedule showing how the yearly and cumulative-to-date percentages were calculated for each of the programs. A program manager for one of the targets stated that “the 3 percent target was determined using qualitative analysis conducted by the program manager based on a variety of inputs, such as projected budgets, last year’s performance milestones, and refinement of goals in Defense Programs.” However, the program office was not able to provide documentation that demonstrated how the current year percentage of completion and the cumulative percentage of completion-to-date were derived for either one of the targets.
- NNSA target NA GG 1.34.01, “Mission-Essential Facilities Availability,” was assessed as “green” for the 3rd quarter in Joule. This target was to have mission-essential facilities available 90% of the scheduled days for the year. The program office provided spreadsheets from eight Department contractor sites that contributed to this target. The spreadsheets summarized, by site, the number of scheduled days available, the number of actual days available, and a calculation of percentage of scheduled days actually available. Our requests for supporting documentation included a detailed population of facilities for each site, showing the days that each facility was scheduled to be available versus the days that the facilities were actually available. In addition, we expected to see a projection of results for the 4th quarter using actual results as of the end of the 3rd quarter, since this target is only assessed on a quarterly basis as to its progress against the yearly target. We were not provided with support to substantiate the actual results through the 3rd quarter that could be projected through the 4th quarter. When we requested daily logs from facilities involved in this target to support the sites schedules that listed the summarized number of scheduled and actual days available, NNSA management declined to provide any further supporting documentation.
- NE
 - NE target NE GG 4.17.1, “Radiological Facilities Management,” was assessed as “green” for the 3rd quarter in Joule. The target proposed to maintain a Facility

STATUS OF PRIOR YEAR FINDINGS

Operability Index (FOI) of 0.9 for Radiological Facilities Management and Idaho Facilities Management. The FOI consisted of individual indices from each of three Department programs: 1) Idaho Facilities Management, 2) Space and Defense Power Systems, and 3) Medical Isotopes. We requested supporting documentation for a sample of factors from each of the three programs. As we began to make our requests, the program contact discussed this annual target with us in general and specifically related to Idaho activity, and informed us that “the support for this target is not very good,” “they would work to improve the support for next year,” and “it will be changed.” Specifically, we found:

- The Medical Isotopes program was able to provide sufficient supporting documentation.
- The Space and Defense Power Systems program provided sufficient supporting documentation for all of its factors not related to the Idaho National Laboratory (INL). However, our program contact stated that there was a “lack of support” for the INL portion of the index. Adequate support was eventually provided for some of the INL factors, but not all of them.
- The Idaho Facilities Management program did not provide sufficient supporting documentation. When we first attempted to sub-sample some of the factors for this index, the program manager disclosed that he would not be able to provide much in the way of support for the majority of the factors, saying that “if you sample these, it will be hard to provide information,” as seven of the twelve index factors for this program consisted of electronic and/or phone communications of status with the Idaho Operations Office FOI coordinators, with no other supporting documentation noted. Despite many further attempts, NE could not provide supporting documentation for these communications that would support the assessment of its 3rd quarter Joule results. For one of the factors, our program contact noted that almost all of the documentation supporting the factor for the fiscal year prior to August 2006 had been deleted from the program manager’s computer.

- **OCRWM**

- OCRWM target RW GG 7.25.3, “Reduce Management Program Funding,” was assessed as green for the 3rd quarter in Joule. The initial documentation provided by OCRWM supported its reporting in Joule, but was not considered adequate to support the assessment. A request for further support yielded documentation that refuted the assessment. When asked to clarify which support was correct, OCRWM disclosed that it had used the wrong data in the initial computation of the 3rd quarter result for this target. OCRWM only became aware of this error as a result of the audit inquiry. Once the error was discovered, OCRWM corrected the scoring for this target.

The Department’s internal controls over the accuracy of performance reporting are not operating effectively. Specifically, the Department’s existing documentation

STATUS OF PRIOR YEAR FINDINGS

requirements are not being consistently applied by all Headquarters, field and contractor elements that provide performance information for reporting in Joule. Furthermore, we were informed that a supervisory review of performance data reported, or to be reported, is not consistently performed by all Departmental elements.

As a result, the Department does not have adequate internal controls to ensure that performance information reported in the Joule system reflects actual performance and that it is supported by documentation that will withstand the rigors of an audit.

The Department's inability to accurately report the results of all performance measures in the PAR limits the ability of the reader to correctly assess the performance of the Department. In addition, by not having adequate internal controls in place to ensure that documentation exists that supports the actual performance for each of its annual targets, the Department risks presenting inaccurate performance results to readers of the PAR. As a result, those readers, including Congress, the President, the general public, and other stakeholders, can not properly assess the results of those targets.

Statistical analysis prepared to evaluate the effect of the six incorrectly reported or unsupported performance targets across the entire population of the Department's 204 annual performance targets determined, with 96 percent confidence, that about 21 percent, and possibly as many as 58 percent, of the targets were incorrectly reported or unsupported.

Recommendations:

1. We recommended that the Department's CFO:
 - a. Ensure that documentation and maintenance requirements are conveyed to, and consistently applied by, all Headquarters, field, and contractor elements that provide information relied upon for reporting performance results into Joule;
 - b. Strengthen and enhance existing internal controls to ensure that all targets are supported by substantive underlying data, and the data has been subjected to a supervisory review when the result is initially reported in the Joule system. Supporting documentation should be available at any time to confirm reported results (including quarterly milestones); and
 - c. Provide training and guidance to all Departmental elements regarding the timely compilation and maintenance of appropriate supporting documentation that will be used to substantiate target assessment.

Management Reaction:

The CFO generally concurs with the auditors' recommendations that we strengthen internal controls to ensure the accuracy of reported performance data and the maintenance of related supporting documentation. The Department has already successfully implemented an internal controls procedure for performance measures resulting in the removal of a reportable condition in FY 2004. The Department will

STATUS OF PRIOR YEAR FINDINGS

recommit to strengthening the documentation requirements of the existing procedures and ensure training is provided to applicable Departmental elements.

Management will strengthen the procedures pertaining to quality of the reported results and supporting documentation prior to official submission. To that end, management will work to improve guidance with respect to quality control of submitted performance results in the internal control procedures, and encourage appropriate management oversight of those submissions. The end result is to ensure that errors do not occur in the data calculation and reporting process, and if they do that those errors are detected and corrected before performance data is officially submitted into Joule.

Management disagrees with the characterizations of GG 1.34.01: “NNSA management declined to provide ...” Following the auditors’ request for daily facility logs, it was determined by the NNSA program manager and NNSA staff that it would take at least a month to collect additional information for the estimated 1,600 facilities covered by the measure. As such, they declined to undertake this in view of the constrained time available to provide any additional information to the auditors.

Management agrees that for NE target NE GG 4.17.1, “Maintain Operability of Radiological Facilities Management and Idaho Facilities Management-funded Facilities,” the Department should improve the transparency of its supporting documentation by standardizing a formal documentation of its facility availability data. Management disagrees that the result provided by NE is not supportable. First, the statements quoted above were part of much broader NE statement that, in context, explains the process for ensuring that the availability of the facilities were correctly reported. Not quoted is the fact that there are multiple sources for confirming the availability of the facilities such as maintenance logs and user reports that collectively and independently confirm the status of the facilities for use. Also unmentioned is a discussion of the difference between erroneous reporting and fraudulent reporting. Erroneous reporting is highly unlikely since the primary purpose of the weekly facility manager meetings were to discuss the status of the facility (availability) and upcoming use. Fraudulent reporting is also highly unlikely due to the multiple methods of confirming the availability of a facility that cannot be manipulated by a facility manager such as maintenance logs with associated maintenance costs and the independent user reports.

Management disagrees with the “Background” summary articulated in this finding. Alternative wording was suggested in a previous draft provided to the KPMG team that was not included in this final version. As written, the background summary is not factually precise with respect to the process of submitting performance information into Joule and the assignment of color codes.

Generally speaking, management disagrees with the extensive use of quotes in this finding. The finding could be written in a persuasive and factual manner without the use of the quotes. No known transcript of these quotes was provided to management for review and concurrence. A general recollection of the conversations by managements suggests that some of these quotes are taken out of context, to the point of incorrectly implying that

STATUS OF PRIOR YEAR FINDINGS

program staff were not taking steps to provide requested information and take corrective steps.

Auditor Comment:

We incorporated nearly all of the Department's suggestions regarding the background section of the issued finding.

As indicated above, the Department's internal controls were not adequate to ensure that performance information reported in the Joule system reflected actual performance and that sufficient documentation existed and was readily available. In addition, the Department's internal controls to ensure accurate performance reporting were not operating effectively.

A key step in our internal process for issuing any finding to DOE management involves providing a draft version of the finding to management for factual verification. We performed that step for this finding, and incorporated the comments received from management. In addition, program personnel had ample opportunity to provide supporting documentation for the sampled measures. We provided multiple extensions to program personnel, and the auditors worked extensively with program personnel to review multiple iterations of supporting documentation. However, as our test work progressed, it was apparent that the Department's existing documentation requirements were not being consistently applied by all Departmental elements that provide information relied upon for reporting performance results into Joule. These controls must be strengthened to ensure that readers of the *Performance and Accountability Report* have accurate performance results to allow them to properly assess the annual and historical performance of the Department.

Tabled Finding 2: Quarterly Milestone Reporting (06-XN9-PERF-03)

The NNSA program office reports quarterly progress towards annual targets instead of quarterly targets. This is done by using the performance through the end of a quarter, discussions with site personnel and program managers, and any other available information, and using this information to project the program's assessment as to its ability to complete the annual target. To illustrate, the quoted discussion below describes NNSA's analysis at the end of the FY 2006 3rd quarter for evaluating annual target NA GG 1.31.04, *Total ASC Computing Capability for All Platforms*:

Annual and Endpoint Targets are generated through a detailed analysis of work projected to develop the critical capabilities – each is managed as a development project. The Annual Target is adjusted based on the annual appropriation and the most recent actual program results. Then, for this FY 2006 target (attaining cumulative capacity of ASC production platforms of 160 teraflops), progress is tracked using site reports, meetings with site program and computer representatives, and telephone discussions with site program and computer representatives. This target is a 4th Quarter target; there is no specific projection for the 3rd Quarter, FY 2006

STATUS OF PRIOR YEAR FINDINGS

for this target. For the 1st, 2nd, & 3rd Quarters, a projection of 4th Quarter status based on current data is made, if site-related data indicates that the total capacity equals or exceeds the target, then the target is reported as “Green” (as was done for 3rd Quarter, FY 2006). To provide evidence of achieving the 160 teraflops target to the auditors, reports from the three laboratories of concern were compiled (attachments two through four). For the 4th Quarter, since all three sites are reporting that the total capacity exceeds the target, the target will be reported as “Green.” The Annual Target has been met prior to the 4th Quarter.

NNSA based its decision to report quarterly progress toward annual targets instead of quarterly targets on a series of electronic mail (e-mail) messages that began March 26, 2003, and detailed a conversation between the Under Secretary of NNSA and the Department’s Deputy Secretary. The e-mail from the NNSA Under Secretary notes that “He (Deputy Secretary) is perfectly comfortable with the quarterly milestone being a subjective evaluation of progress toward the annual goal.” However, there has been no guidance issued by Headquarters that formalizes this agreement. In addition, the NNSA Under Secretary was included on the Distribution List for *Performance Management Responsibilities* guidance issued on April 13, 2004 that requires performance reporting against quarterly milestones.

By not preparing quarterly milestones for its annual targets, NNSA is not in compliance with Departmental guidance.

Recommendations:

2. We recommended that the Department’s CFO:
 - a. Either issue formal guidance providing an exception from current policy to NNSA to allow reporting quarterly progress towards annual targets, or
 - b. Require NNSA to develop quarterly milestones and report actual quarterly performance against the milestones.

Management Reaction:

Management generally agreed with our findings and its comments were responsive to our recommendations. Management provided the following clarifying comments: “Management will prepare guidance on reporting quarterly progress against an annual target as an acceptable approach to reporting quarterly performance measure results. This recommendation is consistent with the annual budget process. Reporting quarterly progress against annual targets promotes good program management practice by requiring periodic, systematic and formal progress reviews.”

ACRONYMS

AFDCS	Active Facilities Data Collection System
AFR	Agency Financial Report
ADFM	Associate Director Facility Managers
Argonne	Argonne National Laboratory
B&R	Budget and Reporting
CAD	Computer Assisted Design
CFO	Chief Financial Officer
CID	Contract Identification Number
CWIP	Construction Work-In-Process
Chicago	Chicago Operations Office
D&D	Deactivation and Decommissioning
Department or DOE	Department of Energy
EFASC	Energy Finance and Accounting Service Center
ES&H	Environmental, Safety, and Health
EM	Environmental Management
EMCBC	Environmental Management Consolidated Business Center
eWFO	Electronic Work for Others
FAC	Federal Administrative Charge
FEGLI	Federal Employee Group Life Insurance
FEHB	Federal Employee Health Benefits
Fermi	Fermi National Accelerator Laboratory
FIMS	Facility Information Management System
FOI	Facility Operability Index
FY	Fiscal Year
Idaho	Idaho Operations Office
IE	Inter-entity
INL	Idaho National Laboratory
IPABS	Integrated Planning, Accountability, and Budgeting System
KCP	Kansas City Plant
LANL or Los Alamos	Los Alamos National Laboratory
LBNL	Lawrence Berkeley National Laboratory
LLNL	Lawrence Livermore National Laboratory
LTS	Long-Term Stewardship
MLOA	Military Leave of Absence
NE	Nuclear Energy
NETL	National Energy Technology Laboratory
NNSA	National Nuclear Security Administration
OCFO	Office of Chief Financial Officer
OCRWM	Office of Civilian Radioactive Waste Management
OIG	Office of Inspector General
ORP	Office of River Protection
ORFSC	Oak Ridge Financial Service Center

ACRONYMS

PAD	Paducah
PAR	Performance and Accountability Report
PBS	Project Baseline Summary
PP&E	Property, Plant, and Equipment
PO	Purchase Order
PORTS	Portsmouth
PPPO	Portsmouth Paducah Project Office
PRN	Preliminary Request Notice
R&D	Research and Development
REL	Restructured Environmental Liabilities
RSSI	Required Supplementary Stewardship Information
Richland	Richland Operations Office
SC	Service Center
SF	Standard Form
SMWU	Solid Waste Management Units
STARS	Standard Accounting and Reporting System
SFFAS	Statement of Federal Financial Accounting Standards
Sandia	Sandia National Laboratories
Service Center	NNSA Service Center
WIPP	Waste Isolation Pilot Plant
WFO	Work for Others
TA	Technical Area
TRU	Transuranic
Treasury	U. S. Department of the Treasury
UDO	Undelivered Orders
VIAS	Vendor Invoice Approving System